Insolvency and Bankruptcy Code The Game Changer

LSI
INSOLVENCY PROFESSIONAL ENTITY

THE TIMES GROUP

PRESENT

Insolvency and Bankruptcy Code

The Game Changer

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Foreword

M C Govardhana Rangan

Editor, Finance & Markets,
The Economic Times

For decades, one of the most favoured ways of bankers in India to recover funds from defaulters was to give them more loans. When a company is unable to pay lenders, it would invariably tell the bankers that only when it is lent more money it would be able to run the business and repay. If not, the business would go down the drain and bankers would get nothing back.

It was the classical John Keynes' saying playing out: 'If you owe your bank a hundred pounds, you have a problem. But if you owe a million, it has,' playing out in the entire banking industry.'

Although India tried out many legislation in the past including The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI Act), 2002, they were ineffective because of their design which were liberal towards the borrowers than the lenders.

The notorious snail-paced judiciary helped defaulters game the system. Courts would take years to settle claims, and in the process either the promoter has siphoned off the funds and fled the country, or the asset rusted away.

Resolution of any default requires timely action. The Insolvency and Bankruptcy Code apart from being effective in many aspects, prescribes the timeline to resolve the issues. Lenders couldn't have asked for more.

Since the Act came into force many scenes have played out in the courtrooms and with the regulator. What it reflects is how the regulator is moving forward to make the system more efficient and how the promoters who have successfully gamed the system continue to think they could succeed even in the age of IBC.

This edition of Insolvency & Bankruptcy Code – The Game Changer aims to capture the evolution of the bankruptcy code which both the bankers and lawyers say is probably on par with what's prevalent in the advanced Western world that helps allocate capital efficiently.

The contents of this book are organised in four chapters. Apart from examining the details of the IBC, it also looks at some of the industrial segments which piled up huge debt and hence been the focus of resolution.

Chapter 1 deals with the IBC Time Line, the Evolving Landscape, and tells you why Slow Credit Hurts. Also, the government which was keen on setting the house in order and wanted credit to flow to genuine businesses was particular that the law did not contain loopholes as in the past.

In Chapter 2, infrastructure, steel and power industries are in focus as they are among the worst hit because of the bankruptcy code. There may be noise about the law being unfair to them, but the law cannot discriminate between one sector and the other. At the end of the day, it is the money of the depositor which banks need to return.

It is also a time when certain ways of dealing between the government and businesses have to change. Power sector has been specifically in stress not because of the law, but because of its own self-inflicted wounds.

Only when one door shuts, the other opens. That may be the case of infrastructure funding. With banks hesitant to fund these long gestation projects due to bad loans and the strict recovery laws, long term funds and right mechanism to fund them may evolve.

Telecom and textiles are in bad shape too. Evolving technology and competitive landscape on a global level have been bad to these two industries. Historically, these would have leaned on banks to keep them afloat without recognising the bad business models. Thanks to the IBC, their business models and management practices also need to evolve.

Nearly a dozen banks were in the Reserve Bank of India's Prompt Corrective Action mechanism because of their poor financials and they were forbidden from lending. What is a bank for if it can't lend? How does it lend without recovering money from those from whom it already has lent money? For many of the medium sized banks, the IBC is nothing less than a blessing.

There are certain specific benefits that come to companies in the form of new engineering techniques. Once a new buyer emerges he identifies the ways to reduce costs and make the company more efficient in which engineering consultants play a vital role.

Engineering, block chain and cross border insolvency are the new ideas that Chapter 3 of the book covers. Mutual funds which have become a key financial intermediary in helping India achieving 8 percent economic expansion can be more confident in lending to corporates with the promise of timely recovery of funds.

To declare a legislation a success or a failure in less than three years of its existence wouldn't be doing injustice to any law, more so for the IBC which is attempting to rewrite the way Indian businessmen conduct themselves and how banks asses credit.

Case law is just building up. There have been some rulings which have diluted the purpose of the IBC and there have been some temptations such as treating operational creditors on par with financial creditors. In Chapter 4, some of the recent judgements are being analysed.

Hope this collection of writing provides you an insight into where the Indian economy is headed with a law that put the nation on global stage in the eyes of investors. This is also a showcase reform of the government.

Chapter 1

LSI Resolution

Indian financial sector has been recently suffering from stressed assets problem due to various reasons. Debt recovery rate happens to be amongst the lowest in the world. It is expected that with the implementation of Insolvency & Bankruptcy Code (2016), the recovery rate would improve substantially.

LSI Resolution (P) Ltd., an Insolvency Professional Entity (IPE) recognised by Insolvency & Bankruptcy Board of India (IBBI), is a vibrant player in the emerging Insolvency Resolution regime and would be instrumental in this game changing process of debt recovery.

Strength of LSI

LSI Resolution (P) Ltd. with its already acquired expertise in Techno Economic Viability study, aspires to be an IPE of repute by making available the best of services from Insolvency Resolution Professionals. It is a well-known company in the financial market specially in the field of Restructuring and Merger & Acquisition. The company has a team of eminent professionals like former Bankers, Chartered Accountants, Cost Accountants, Engineers, Project Consultants under one roof that provides support to the Insolvency Professionals (IPs) along with strong infrastructural and manpower support.

LSI Resolution is receiving continuous valuable guidance from former banking and industry stalwarts. With the patronage and support of all, LSI Resolution wants to grow into one of the most sought-after resolution service providers in the country in years to come.

Services provided by the Insolvency Professionals (IPs) of LSI

IPs of LSI Resolution having extensive knowledge and wide experience in their respective fields, are providing best of services in carrying out the Resolution/ Liquidation process successfully.

LSI Resolution (P) Ltd. has offices in Delhi, Mumbai, Kolkata and Hyderabad.

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Chapter 2

IBC Timeline

PRE CODE

- SICA
- BIFR
- SARFAESI ACT
- CDR

21 DECEMBER 2015

The Insolvency and Bankruptcy Code, was introduced in the Lok Sabha by the Finance Minister

23 DECEMBER 2015

Referred to a Joint Committee of Parliament, recommended by the Committee on 28 April 2016

5 MAY 2016

The Code was passed by the Lok Sabha

Indian Bankruptcy Code

Citation Act No. 31 of 2016
Territorial Extent - India
Enacted by Lok Sabha
Date passed 5 May 2016
Enacted by Rajya Sabha
Date passed 11 May 2016
Date assented to 28 May 2016
Date commenced 28 May 2016

11 MAY 2016

IBC passed by the Rajya Sabha

28 MAY 2016

The Code received assent from President Pranab Mukherjee

28 MAY 2016

Was notified in The Gazette of India

DECEMBER 2016

The Code became effective

Legislative History

Bill introduced in the Lok Sabha as
The Insolvency and Bankruptcy Code, 2016

Bill citation Bill No. 349 of 2015
Bill published on 21 December 2015
Introduced by finance minister Arun Jaitley
Committee Report and Report of the Joint Committee
Date passed by conference committee 28 April 2016

Footnote :
The aim was also to repeal the Presidency Towns Insolvency Act, 1909 and Sick Industrial Companies (Special Provisions) Repeal Act, 2003, among others.

EVOLVING LANDSCAPE

India, until the introduction of the present 'Insolvency and Bankruptcy Code 2016', had offered a multi-pronged solution to address the problem of recovery of bad debts and revitalising failing businesses. As many as 13 enactments dealing with insolvency and bankruptcy existed in the absence of a single law

IMAGESBAZAAR

What is common in between the Dutch painter Rambrant, Oscar Wilde, the legendary footballer George Best, Francis Ford Coppola, Boris Becker and many others?

Well they all went bankrupt once in their lives and had a sad end to their success stories.

At home, our list seems endless. Though many small and mid-sized businesses have failed in business and in paying debts, it is the industry barons who have failed to keep heads above water in remaining solvent. Theirs is a default in very high debts, poor management of funds and lack of transparency in handling regular course of corporate affairs.

Pre-IBC Days

Recovering loans has always been a tough job for creditors. The matter worsens when borrowers wilfully decide to default, and perhaps get away with it. What is considered a marriage between the borrower and the lender that had once been inked as a promise of continuity can later lead to a divorce. As most of such cases ends up in bitter disputes, the only route left for lenders to recover their money is to seek justice.
But court processes could be long, and often ridden with complicated legal wrangles. It simply took very long to get a resolution in favour of a creditor.

Widespread industrial sickness affected the Indian economy in a number of ways, such as loss of government revenue, tying up scarce resources in sick units, increasing non-performing assets held by banks and financial institutions, increasing unemployment, loss of production and poor productivity.

Whatever could be the process of recovery — the aim of law makers was to salvage and if possible recover potential businesses. Total closure of industries cost more to the government, with the labours loosing the most.

Sick Industrial Companies Act (SICA), 1985

This was a key piece of legislation to deal with the growing menace of industrial sickness in India. It was enacted to address the chronic problem in the Indian economy — industrial sickness. Its implementation was aimed towards rectifying adverse effects of socio-economic consequences.

SICA was formed to detect sick or potentially sick companies or industries and work out a revival plan. If the plan did not work then, it would lead towards the unit's closure and paying off creditors to the extent possible through the proceedings of money raised from sale of physical assets. It was a measure taken to release investments locked up in non-productive companies for productive use elsewhere.

In 1991, SICA was amended to include public sector enterprises in the board's purview. Later it was repealed and replaced by the Sick Industrial Companies (Special Provisions) Repeal Act of 2003, which diluted some of SICA's provisions and plugged loopholes. An important change was, apart from combating industrial sickness, to reduce the growing incidence of sickness by ensuring that companies did not resort to 'sickness declaration' merely to escape legal obligations and ask for concessions from financial institutions.

> The act defined a sick industrial unit as one that had existed for at least five years and had incurred accumulated losses equal to or exceeding its entire net worth at the end of any financial year

Board of Industrial and Financial Reconstruction (BIFR)

The Board for Industrial and Financial Reconstruction (BIFR) was set up in January 1987 by the then government with the objective to determine sickness of industrial companies and to assist in reviving those that were viable, while shutting down others. It was set up as a Government of India agency and as a part of the department of Financial Services of the Ministry of Finance. A new industrial policy was placed before the Parliament on July 24, 1991 aiming to maintain growth in productivity and gainful employment. It also encouraged the growth of entrepreneurship and up-gradation of technology.

Way back in 2001, the Companies (Amendment) Bill, 2001 was introduced as the government felt that the BIFR had not met its objective of preventing industrial sickness. In a significant change, in December 2016, the government dissolved BIFR and referred all proceedings to the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) as per provisions of Insolvency and Bankruptcy Code.

SARFAESI Act

The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 placed corporate debts outside the purview of the BIFR. It was prevalent to be referred to BIFR as it served as a haven for promoters of sick companies. The new act gave banks and financial institutions a better tool to recover bad debts. It was complemented by the corporate debt restructuring package under which lenders and borrowers would meet to agree on a way of recasting stressed debt.

It was the first Indian law that allows banks and other financial institution to auction residential or commercial properties to recover loans. In fact the first asset reconstruction company ARCIL, was set up under this act. Under this act creditors such as banks or financial institutions had the right to enforce security interest under section 13.

Corporate Debt Reconstruction (CDR)

The process of corporate debt restructuring was introduced in 2001 with the Reserve Bank of India coming up with certain guidelines to be followed by banks and other financial institutions. The major benefit the creditor got from restructuring debts is that it allowed reduction of non-performing assets of a company. CDR was non-statutory and voluntary process where 75 per cent of creditors by value decided to aid the company by restructuring its debts.

It was available to companies with multiple creditors and covered all categories of assets. Cases that qualified for reconstruction under CDR were filed with the Debt Recovery Tribunal, The Bureau of Industrial and Financial Reconstruction. A bank or a financial institution could refer a company for CDR if it had 20 per cent or more as working capital or term loan of the company.

Strategic Debt Restructuring (SDR)

Strategic Debt Restructuring made it possible for banks to convert loans given to corporate businesses into equity, either in full portion of the loan or in portion. The scheme was introduced by RBI in mid 2015 to recover loan by taking control of the non-performing company.

Sustainable Structuring of Stressed Assets (S4A)

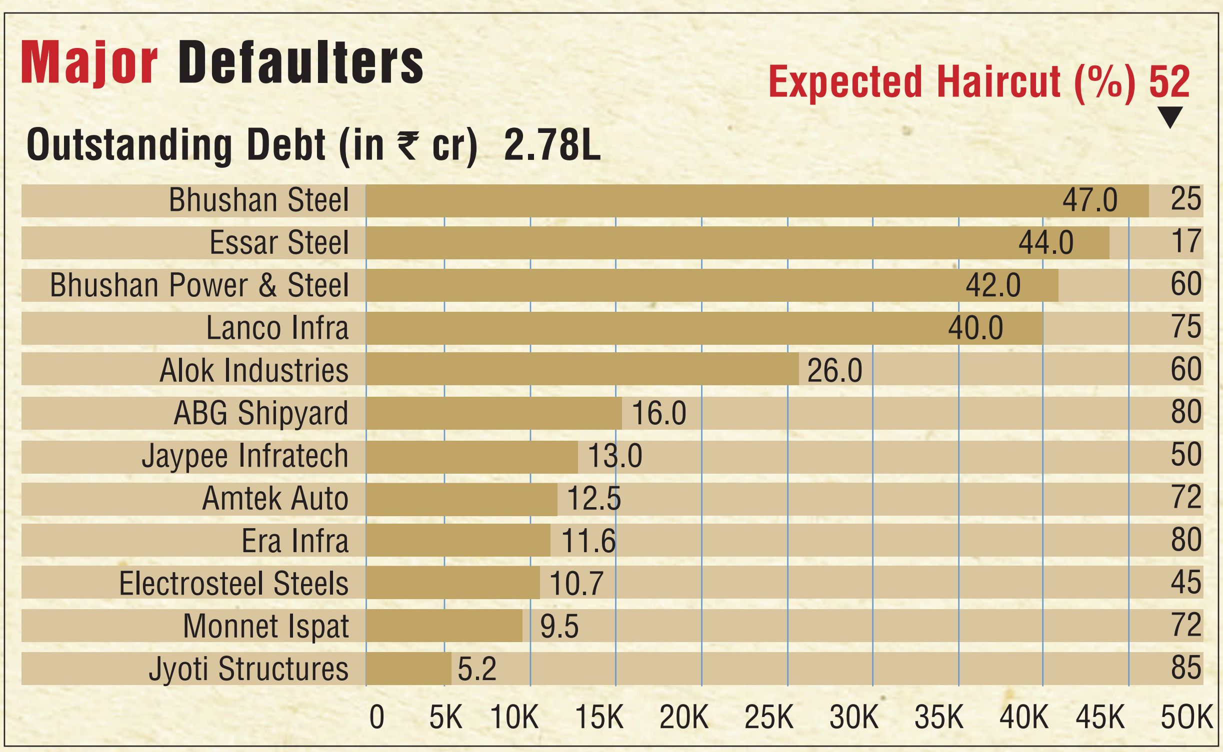
In mid June 2016, the apex bank had set up the 'Sustainable Structuring of Stressed Assets (S4A Scheme)' that made it possible for banks to structurally reconstitute large stressed assets in corporate businesses with bank debts. It also allowed the existing promoter to continue in management even as a minority and offered an option to lending banks to hold convertible debentures along or without equity holding.

Later, the Reserve Bank of India scrapped numerous loan restructuring programmes prevalent among banks for restructuring defaulted loans. It made time bound resolution of defaults with the Insolvency and Bankruptcy Code becoming the main tool to deal with defaulters. Almost all schemes, Corporate Debt Restructuring, Sustainable Structuring of Stressed Assets or S4A, Strategic Debt Restructuring and Flexible Structuring of Existing Long Term Project Loans, Joint Lenders Forum have been done away with.

NCLT & NCLAT

The Sick Industrial Companies (Special Provisions) Repeal Act, 2003 replaced SICA and sought to dissolve the BIFR and the Appellate Authority for Industrial and Financial Reconstruction (AAIFR), replacing them with the NCLT (National Company Law Tribunal) and NCLAT (National Company Law Appellate Tribunal). However, legal hurdles prevented the NCLT from being constituted initially.

With the formation of NCLT and the NCLAT took over some of the functions of BIFR and other bodies. The aim was to hasten up the process of winding up sick companies.



Source: CLSA

K = 1000

Slow Credit Hurts

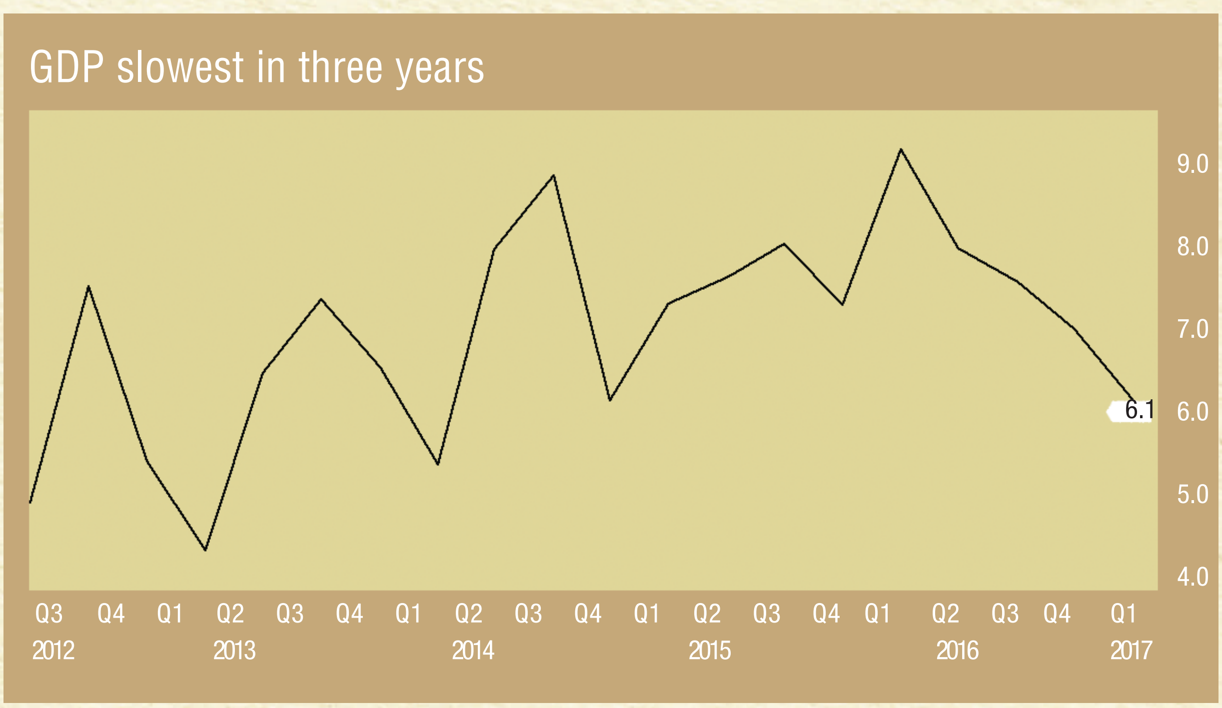
Investment in industries by financial institutions began to decline considerably as lenders became wary of making fresh commitments

Lack of free funds flow hurts. And it hurts all — the large and small business houses and even individuals. Indian economy has been passing through one of the toughest testing times with all factors for revival taking a hit. It has been a surprise for many, as India in the past couple of years has been proclaimed as one of the fastest developing country.

It could be of interest at this juncture to look into the various factors that led to the NPA disaster. The past few years saw a plethora of industries, mostly with mega investments, going bad for various reasons. These have unfortunately locked borrowed funds from financial institutions and various other lenders.

During 2000-08 — the boom phase in Indian economy — banks, particularly those from the public sector, lent extensively to corporate businesses. Unfortunately, profits of most of the corporate businesses dwindled due to slowdown in the global economy, mining projects ban and delay in environmental related

India's Slowing Growth



permits affecting power and iron and steel sectors. There was also price volatility and shortage of raw materials. This affected their ability to pay back loans — one of the major causes for the growing menace of NPA in the Indian economy.
Yet, another reason is the relaxation of lending norms, particularly for big corporate business. Big and glamourous names took the fancy of lenders. They have said to have enjoyed easy access to finances without having to go through due credit rating of projects. Also, to be in competition, banks disbursed unsecured loans, most of which failed subsequently.

Five sectors — textile, aviation, mining, infrastructure, iron and steel contributed in most of the NPA crisis. Most of these were financed by public sector banks which now bear the brunt of a massive pile up of unpaid loans. It may be noted that public sector banks provide around 80 per cent of credit to industries and it is this part of the credit distribution that forms a great chunk of NPA.

Industrial sickness in India is a chronic disease. It is laden with high cost of investments, labour militancy, lack of demand of the products manufactured and the incidental unascertainable costs. In a broad perspective the causes for sickness were internal and external. Internal factors responsible were wrong planning in relation to location, technology, capital cost, technological obsolescence, management deficiencies and industrial unrest.

External factors were government policies on pricing, duties, taxes, high interest rates, taxes on profit, slackness in demand, sluggishness in export markets, high labour cost, inadequate availability of key inputs and lack of infrastructure. However, diversion of funds from the business and wilful defaults are also major contributors to NPA piling up.

A combination of all the above led to the closure or default of many large projects, particularly in core industries such as iron and steel, power and infrastructure. A few factors such as high cost of key inputs, non-availability of raw material, changes in government policies have led to many industrial units becoming sick. Lack of finance, including weak equity base, poor utilisation of assets, inefficient working capital utilisation, absence of costing and pricing, absence of planning and budgeting, inappropriate utilisation or diversion of funds also aggravated situations.

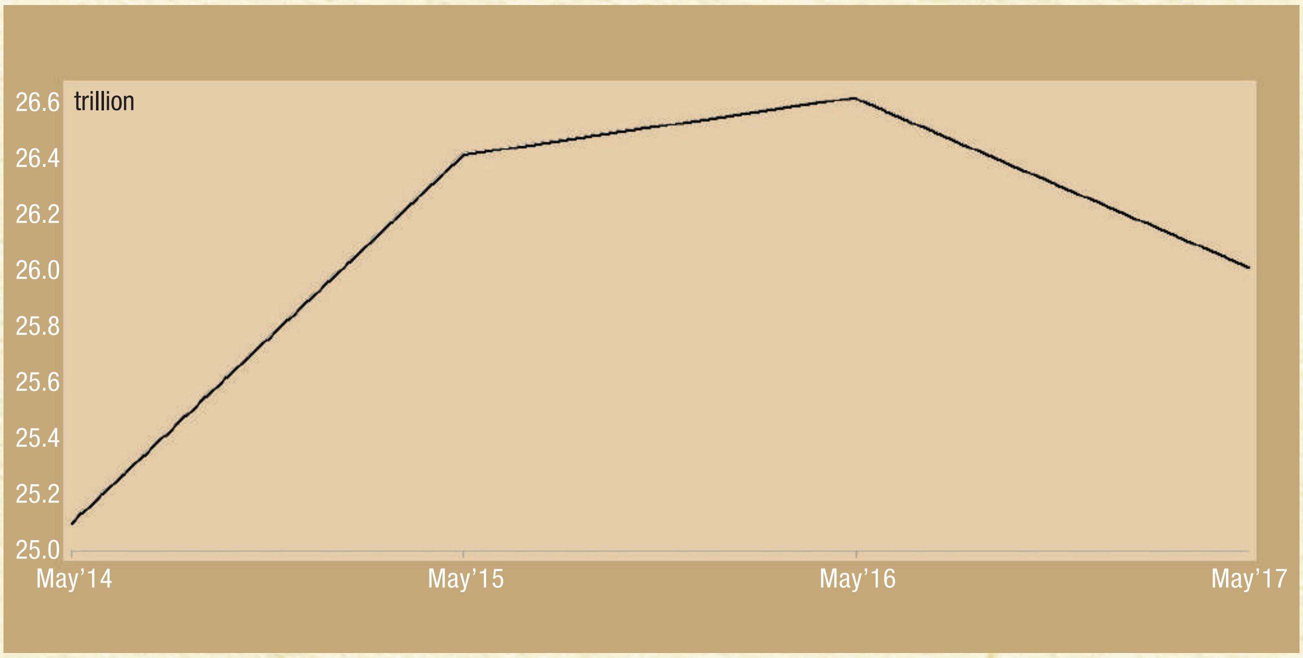
Banks and lending institutions have also been saddled with a unique problem of being faced with ineffective recovery tribunals. And here, the Insolvency and Bankruptcy

Code promises to offer swift and meaningful solutions for recovering from non-performing assets.

Has it been a case of choosing the wrong business to be in? Was it a case of wilfully defaulting in paying loans? It is true that promoters have had a free run till the bubble bursted. A bigger causes for industrial sickness and the NPA build up points to management inefficiency and choice of technology and products that quickly fell out of demand.

Lack of professional and experienced management and dependence on hereditary management also is a factor that caused sickness. Inefficient management resulted in the inability to perceive things in proper perspective, devoid of routine considerations. Technology used is now being questioned as they have not yielded profits to payoff. In many cases the project appraisal has not been adequate and at times ineffective. A question on competency of appraising authorities have also been raised as most of the mega and mid-sized projects that have crossed the NPA line are said to have used technology that were too outdated from being competitive and remunerative.

Declining Bank Credit to Industry



*Source: RBI * Chart in Indian Rupees*

Birth of A Code (IBC 2016)

A strong insolvency framework to attain resolution or liquidation at a minimal cost and time was long overdue in India. The Insolvency and Bankruptcy Code aims to protect the interests of small investors and make the process of doing business less cumbersome

In May 2016, Indian economic reforms took a bold step forward when the Rajya Sabha passed a major economic reform bill — 'Insolvency and Bankruptcy Code, 2016'. The bill, moved by the government, is considered as the biggest economic reform, next only to GST.

In an effort to break away from the past, the Insolvency and Bankruptcy Code has been a successful model designed primarily to streamline insolvency resolution process, which among other things, prevents value destruction in distress.

The core vision of the new law is to encourage entrepreneurship and innovation. It is true that some business ventures fail. Their processes of resolution need to be handled efficiently and swiftly. Entrepreneurs and lenders will now be able to move on instead of being bogged down with decisions taken in the past. The essential concept of the new law is that when an organisation defaults in its payment of debt, the control shifts from the shareholders or its promoters to a committee of creditors who have time bound period to evaluate proposals from various stakeholders on restructuring the company. If the process is not viable then an effective route to liquidation is to be taken.

Decisions taken in a time-bound manner lead to a greater chance of a firm being saved as an on-going organisation. With this achieved, its assets can be used productively for a greater cause of the economy. Labour and capital is, thus, best put to use. Notably, this is a complete departure from the process and experiences under the SICA regime where there were delays leading to destruction of core assets value of firms in distress.

The bankruptcy law consolidates all existing framework by creating a single law for insolvency and bankruptcy process. All laws related to insolvency in India have been brought under the Insolvency Code by putting them under a single law. The single reason for this is to resolve matters of bankruptcy as quickly as possible through a time bound manner and also by saving on recurring costs of long processes. Earlier, processes of insolvency took long to process and did not offer economically viable solutions.

This was long overdue in India and has been well accepted by all — industry, as well as the authorities. Its aim is reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximisation of value of assets.

It also aims at promoting entrepreneurship, make credit available and balance interests of all the stakeholders even if there are alterations in the order of priority of payment of government dues.

In India, priorities are many and the focus has always laid emphasis on finding solutions for the credit balance problems, developing a strong and robust corporate bond market, improving credit and build on India's competitiveness globally as a business destination. The focus was also aimed to develop industries and business as an impetus of the government's 'Make In India' drive. What was absent was a single window system through which insolvent companies could be processed for liquidation and unlock their funds for more meaningful investments or reinvestments.

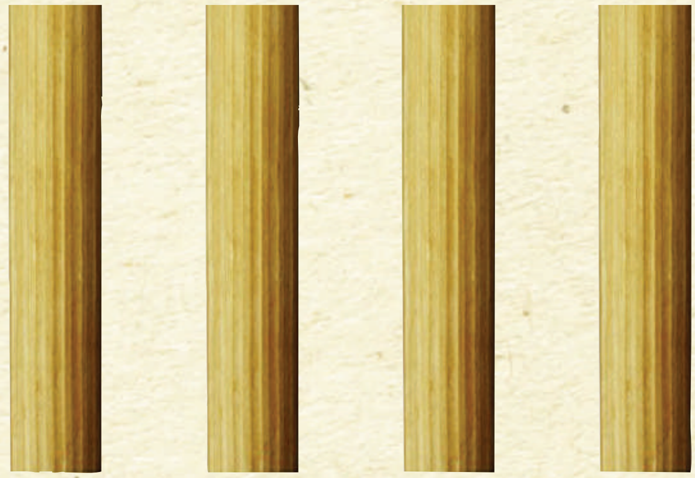
The new code was thus designed to streamline corporate insolvency resolution process without value destruction in case of corporate distress. The resolution process is a representative action for the general body of creditors rather than a recovery process of money of an individual creditor.

It has been described as a comprehensive and systemic reform that will lead to a quantum leap in the functioning of the credit market. It is meant to take India from relatively weak insolvency regimes to provide one of the world's best insolvency resolution platforms. It lays the foundations for the development of the corporate bond market, which would finance the infrastructure projects of the future.

The Code is thus expected to provide a big boost to 'Ease of Doing Business' in India. The IBC has been praised by the World Bank and International Monetary Fund as it simplifies the process of liquidation in a time bound manner — to resolve cases within 180 days that can be extendable to 270 days. This has improved India's ranking position in 2018's 'Ease of Doing Business' by 30 places, and as a result, has received significant attention from foreign investors.

Four Pillars of IBC

- Key person - The 'Insolvency Professional'
- New Data Bank of 'Information Utilities'
- Adjudication - NCLT will be the forum
- Regulator - 'The Insolvency and Bankruptcy Board of India'



First
Insolvency Professionals (IP)

IPs play a key role in the efficient working of the bankruptcy process. They are regulated by 'Insolvency Professional Agencies (IPAs)'. IPAs form the frontline regulators and responsible for developing and regulating the profession of IPs.

An Insolvency professional is a person enrolled with an Insolvency Professional Agency (IPA) as member and has a registration with the Insolvency and Bankruptcy Board of India (IBBI). An individual, who is enrolled with an IPA as a professional member and has the required qualification and experience and passed the Limited Insolvency Examination, is registered as an IP. An IP is authorised to provide services as described under the Code.

Functions of an Insolvency Professional

The main and important function of the Insolvency Professional is to assess the financial position of the Debtor company, partnership, LLPs, individual etc. and to ensure smooth process of its revival or dissolution. He should look for opportunities to rescue and salvage businesses, if the situation permits.

One of the primary duties of the Insolvency Professional is to verify the creditor's claims and settle the claim through a resolution or through liquidation process.

Other main functions are

- To analyse financial statements of the company and assess their financial health.
- Understand the receivables position of the company/ Individual and look after the collection process.
- Hold meetings with Committee of Creditors (CoC) and discuss strategies for resolution of insolvency.
- Invite Resolution Plans and put before CoC for approval of the best plan.
- Make arrangements to sell all the assets of the individual or company in case of liquidation.
- Discuss with debtors and creditors and manage their settlement process.
- Involve in the fund distribution process after setting aside money required to pay the costs of resolution or liquidation.
- Deal with the other competing interest, if any.

Insolvency professionals are also required to prepare and submit report to the National Company Law Tribunal with respect to the following:

- Resolution or Liquidation plan and process: This has to be submitted within the stipulated period of commencement of the process by the insolvency professional.
- Detailed report on the asset memorandum.
- Interim report on how the Resolution or Liquidation process is progressing from time to time.
- Details about the sale of all the assets.
- Discussion with the Debtors and Creditors and the conclusions arrived.
- Final report prior to the dissolution of the company, partnership and others.

An insolvency professional must not engage in any employment, except when he has temporarily surrendered his certificate of membership with the insolvency professional agency (IPA) with whom he is enrolled as a professional member.

Qualification of Professionals

The Board may specify categories of professionals or persons possessing such qualifications and experience in the field of finance, law, management, insolvency or such other field, as it deems fit.

Obligations:

- To take reasonable care and diligence while performing his duties;
- To comply with all requirements and terms and conditions specified in the bye-laws of the insolvency professional agency of which he is a member;
- To allow the insolvency professional agency to inspect his records;
- to submit a copy of the records of every proceeding before the Adjudicating Authority to the Board as well as to the insolvency professional agency of which he is a member; and
- To perform his functions in such manner and subject to such conditions as may be specified.

The details of IPs registered as on December 31 2018, IPA-wise **(Number)**

City/Region	Indian Institute of Insolvency Professional of ICAI	ICSI Institute of Insolvency Professionals	Insolvency Professional Agency of Institute of Cost Accountants of India	Total
New Delhi	284	183	45	512
Rest of Northern Region	200	114	30	344
Mumbai	263	84	23	370
Rest of Western Region	183	84	23	290
Chennai	90	49	9	148
Rest of Southern Region	228	126	33	387
Kolkata	134	30	14	178
Rest of Eastern Region	43	13	5	61
Total	**1425**	**683**	**182**	**2290**

Source: *IBBI*

Second
Information Utility

An Information Utility is a professional organisation that is registered with IBBI under Section 210 and provides high-quality authenticated information about debts and defaults. This can be accessed through the Resolution Professionals, Creditors and other stakeholders in the Insolvency Resolution Process so that all stake-holders can make decisions based on the same information.

There is one information utility (IU), namely, the National e-Governance Service Limited (NeSL).

IU is expected to play the key role as on one hand they store the financial information of the users helping the lenders in taking the informed decision about the credit transaction, on the other hand, it would also make debtor cautious as the financial information is available with the utilities. Its major contribution is in the creation of evidence that can be used as evidence in bankruptcy cases.

The main functions are :

- Create and store financial information in a universally accessible format;
- Accept electronic submissions of financial information from persons who are under obligations to submit financial information in such form and manner as may be specified by regulations;
- Accept, in specified form and manner, electronic submissions of financial information from persons who intend to submit such information;
- Meet such minimum service quality standards as may be specified by regulations;
- Get the information received from various persons authenticated by all concerned parties before storing such information;
- Provide access to the financial information stored by it to any person who intends to access such information in such manner as may be specified by regulations;
- Publish such statistical information as may be specified by regulations;
- Have inter-operational ability with other information utilities.

In simple terms and in a broader sense, the new industry of 'Information Utilities' is meant to store facts about lenders and terms of lending in electronic databases. This would eliminate delays and disputes about facts when default does take place.

Details of information with NeSL **(Number except as stated)**

At the end of the quarter	Creditors having Agreement with NeSL		Creditors who have submitted information		Debtors whose info mation is Submitted by Creditors		Loan records onboarded		User Registrations by Debtors		Loan records Authenticated by Debtors		Amount of underlying Debt (Rs. Crore)	
	FCs	OCs	FCs	OCs	FCs	OCs	FCs	OCs	FCs	OCs	FCs	OCs	FCs	OCs
June, 2018	66	NA	21	105	69184	52	191247	105	1024	10	1364	05	NA	NA
Sept, 2018	86	NA	40	144	2016709	530	1222737	207	5111	10	6079	32	2016708	530
Dec, 2018	108	NA	68	140	980724	202	1438390	280	10247	44	10065	35	2732805	1094

Source: *IBBI*

Third

Adjudication

Adjudicating Authority under the Code

In pre IBC era, High Courts, the Company Law Board (CLB), the Board for Industrial and Financial Reconstruction (BIFR) and Debt Recovery Tribunal (DRT) have at times led to overlapping jurisdiction in debt recovery and restructuring.

This caused delay in the process of resolution apart from the complexities in the process. The code intends to overcome these challenges and aims to reduce the burden on the courts as all litigation will be filed under the Code to National Company Law Tribunal (NCLT).

NCLT is the forum where firm insolvency will be heard. This Adjudicating Authority has the jurisdiction over companies, limited liability entities and other entities with limited liabilities. The jurisdiction of the NCLT is based on the registered office of the debtor. Appeals from the order of NCLT shall lie to the National Company Law Appellate Tribunal (NCLAT).

The NCLT will be the appellate authority also for appeals arising out of the orders passed by the Board in respect of insolvency professionals or information utilities.

The Debt Recovery Tribunal or DRT will be the forum where individual insolvencies will be adjudicated. DRTs will the Adjudicating Authority with jurisdiction over individuals and unlimited liability partnership firms. Appeals from the order of DRT shall lie to the Debt Recovery Appellate Tribunal (DRAT).

These institutions, along with their Appellate bodies, viz., NCLAT and DRATs will be adequately strengthened so as to achieve world class functioning of the bankruptcy process.

NATIONAL COMPANY LAW TRIBUNAL BENCHES

S.NO.	NAME OF BENCH	LOCATION	TERRITORIAL JURISDICTION OF THE BENCH
1	(a) National Company Law Tribunal, Principal Bench (b) National Company Law Tribunal, New Delhi Bench	New Delhi	(1) Union Territory of Delhi
2	(a) National Company Law Tribunal, Ahmedabad Bench	Ahmedabad	(1) State of Gujarat (2)State of Madhya Pradesh (3) Union territory of Dadra and Nagar Haveli (4) Union territory of Daman and Diu
3	National Company Law Tribunal, Allahabad Bench	Allahabad	(1) State of Uttar Pradesh (2) State of Uttarakhand
4	National Company Law Tribunal, Bengaluru Bench	Bengaluru	(1) State of Karnataka
5	National Company Law Tribunal, Chandigarh Bench	Chandigarh	(1) State of Himachal Pradesh 2) State of Jammu and Kashmir (3) State of Punjab (4) Union territory of Chandigarh (5) State of Haryana
6	National Company Law Tribunal, Chennai Bench	Chennai	(1) State of Kerala (2) State of Tamil Nadu (3) Union territory of Lakshadweep (4) Union territory of Puducherry
7	National Company Law Tribunal, Cuttack Bench	Cuttack	(1) State of Chhattisgarh (2) State of Odisha
8	National Company Law Tribunal, Guwahati Bench	Guwahati	(1) State of Arunachal Pradesh (2) State of Assam (3) State of Manipur (4) State of Mizoram (5) State of Meghalaya (6) State of Nagaland (7) State of Sikkim (8) State of Tripura
9	National Company Law Tribunal, Hyderabad Bench	Hyderabad	(1) State of Andhra Pradesh (2) State of Telangana
10	National Company Law Tribunal, Jaipur Bench	Jaipur	(1) State of Rajasthan
11	National Company Law Tribunal, Kolkata Bench	Kolkata Bench	(1) State of Bihar (2) State of Jharkhand (3) State of West Bengal (4) Union territory of Andaman and Nicobar Islands
12	National Company Law Tribunal, Mumbai Bench	Mumbai Bench	(1) State of Goa (2) State of Maharashtra

Fourth
Regulator

'The Insolvency and Bankruptcy Board of India'.
This body has the regulatory over-sight over the Insolvency Professional, Insolvency Professional Agencies and Information Utilities.

The Insolvency and Bankruptcy Board of India was established on October 1, 2016 under the Insolvency and Bankruptcy Code, 2016 (Code). It is a key pillar of the ecosystem responsible for implementation of the Code that consolidates and amends the laws relating to reorganization and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner for maximization of the value of assets of such persons, to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

It is a unique regulator: regulates a profession as well as processes. It has regulatory oversight over the Insolvency Professionals, Insolvency Professional Agencies, Insolvency Professional Entities and Information Utilities. It writes and enforces rules for processes, namely, corporate insolvency resolution, corporate liquidation, individual insolvency resolution and individual bankruptcy under the Code. It has recently been tasked to promote the development of, and regulate, the working and practices of, insolvency professionals, insolvency professional agencies and information utilities and other institutions, in furtherance of the purposes of the Code. It has also been designated as the 'Authority' under the Companies (Registered Valuers and Valuation Rules), 2017 for regulation and development of the profession of valuers in the country.

Insolvency Professional Agencies (IPA)
Work relating to insolvency resolution is expected to be handled by Insolvency Professionals. These professionals are required to be registered with Insolvency Professional Agency.

The Insolvency Professional Agencies will develop professional standards, code of ethics and be first level regulator for Insolvency professionals members. This will lead to development of a competitive industry for such professionals.
ICAI, ICSI and ICMA are already registered with IBBI as Insolvency Professional Agency.

Functions of Insolvency Professional Agency

Functions of Insolvency Professional Agency have been specified in section 204 of Insolvency Code as following:

- Granting membership to insolvency professionals.
- Lay down standards of professional conduct to its members.
- Monitor performance of members.
- Safeguard rights, privileges and interests of insolvency professionals.
- Suspend member or cancel membership.
- Redress grievances of members.
- Publish information about its functions, list of members, and performance of its members.

Control over Insolvency Professional Agency is by IBBI

IBBI will exercise control over Insolvency Professional Agency and Insolvency Professional. Complaints can be made to IBBI under section 217 of Insolvency Code. It can carry out investigation of Insolvency Professional Agency and Insolvency Professional under section 218 of Insolvency Code. Disciplinary action can be taken against Insolvency Professional Agency or Insolvency Professional by appointing disciplinary committee under section 220 of the Insolvency Code.

Corporate Insolvency Resolution Process

In a departure from the conventional system of initiating insolvency process the code makes significant departure from the past by shifting the responsibility not only on the financial creditor to initiate the insolvency resolution process but also by corporate debtors and other operational creditors.

Insolvency resolution Process for Companies and Limited Liability Company

If the default is above ₹1 Lakh the creditor may initiate insolvency resolution process the Code proposes two independent stages:

1. **Insolvency Resolution Process -**

During which financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and resurrection; and

2. **Liquidation -**

The process is initiated if the insolvency resolution process fails or financial creditors decide to wind up and distribute the assets of the debtor.

The Process

A financial creditor (himself or jointly with other financial creditors), an operational creditor or the corporate debtor (through corporate applicant i.e. corporate debtor itself; or an authorised member, partner of corporate debtor; or a person who has control and supervision over the financial affairs of the corporate debtor) may initiate corporate insolvency resolution process in case a default is committed by corporate debtor.

An application can be made before the National Company Law Tribunal (NCLT) for initiating the resolution process. Operational creditor needs to give demand notice of 10 days to corporate debtor before approaching the NCLT. If corporate debtor fails to repay dues to operational creditor or fails to show any existing dispute or arbitration, then the operational creditor can approach NCLT.

Corporate insolvency process shall be completed within 180 days of admission of application by NCLT. Upon admission of application by NCLT, creditors' claims will be frozen for an initial 180 days and 90 more days, (if approved by CoC and adjucating authority) during which NCLT will hear proposals for revival and decide on the future course of action. And thereupon, no coercive proceedings can be launched against the corporate debtor in any other forum or under any other law, until approval of resolution plan or until initiation of liquidation process.

NCLT appoints an interim Insolvency Professional (IRP) upon confirmation by the Insolvency and Bankruptcy Board within 14 days of acceptance of application. Interim IP (IRP) holds office for 30 days only. Interim IP takes control of the debtor's assets and company's operations, collect financial information of the debtor from information utilities and other services.

IRP makes public announcement by way of newspaper notification and other means to intimate the corporate insolvency process and calls for submission of claims by any other creditors.

After receiving claims pursuant to public announcement, the IRP will constitute the creditors' committee.

All financial creditors shall be part of creditors' committee and if any financial creditor is related party of corporate debtor, then such financial creditor will not have any right of representation, participation or voting.

Operational creditors should be part of Creditors' Committee (without voting right) if their aggregate dues are not less than 10 per cent of the debt.

Creditors' committee shall meet first within seven days of its constitution and decide by 66 per cent of votes either to replace or confirm interim IP as Resolution Professional. Thereafter a Resolution Professional is appointed by the NCLT upon confirmation by the Board.

The creditors' committee, with a majority of 66 per cent voting share can change a Resolution Professional at any time. The creditors' committee has to then take decisions regarding insolvency resolution by a 66 per cent majority votes.

If 66 per cent of the financial creditors consider that further time is required for resolution beyond 180 days, the NCLT can grant a one-time extension of up to 90 days.

A resolution professional is to conduct entire corporate insolvency resolution process and manage the corporate debtor during the period. He will prepare information memorandum for the purpose of enabling Resolution Applicant to prepare resolution plan. A Resolution Applicant is any person who submits resolution plan to the resolution professional. Upon receipt of resolution plans, Resolution Professional shall place it before the creditors' committee for its approval.

Once a resolution is passed, the creditors' committee has to decide on the restructuring process that could either be a revised repayment plan for the company, or liquidation of the assets of the company. If no decision is made during the resolution process, the debtor's assets will be liquidated to repay the debt.

The resolution plan will be sent to NCLT for final approval, and implemented once approved.

Liquidation

Liquidation process will be initiated if :

- There is a failure to submit the resolution plan to the NCLT within the prescribed period,
- Rejection of resolution plan for non-compliance with the requirements of the Code,
- Decision of creditors' committee based on vote of majority
- Contravention of resolution plan by the debtor.

During liquidation, no suit or other proceedings shall be instituted by or against the corporate debtor. However, it can be made through the liquidator on behalf of corporate debtor with permission of the NCLT.

The Resolution Professional shall act as liquidator unless replaced.

The liquidator shall form an estate of all assets of corporate debtor called the liquidation estate.

Liquidator shall receive, verify and admit or reject, as the case may be, the claims of creditors within the prescribed time. Creditor may appeal to the adjudicator within 14 days.

A secured creditor may either relinquish its security interest to the liquidation estate and receive on priority, the proceeds of the sale by the liquidator or realise its security interest by enforcing, realising, settling, compromising or dealing with the secured asset in accordance with such law as applicable to the secured interest.

Any surplus amount realised will have to be tendered to the liquidator. In case of any shortfall in recovery, the secured creditors will be paid by the liquidator out of the assets of the corporate debtor.

It may be noted here that assets will be distributed by the liquidator in the manner of priorities of debts laid in the IBC (section 53). Individual claimants or those claiming to have any special rights on assets of the debtor will form part of the liquidation process.
All sums due to any workmen or employees such as provident fund, pension and gratuity will be considered as priority dues and is not to be included in the liquidation estate and estate of bankrupt.

Upon the assets of corporate debtor completely liquidated and the liquidator making an application, the NCLT shall pass an order dissolving the corporate debtor.

Fast Track Corporate Insolvency Resolution Process
The Code provides for a fast track insolvency resolution process in respect of corporate debtors, qualification to be notified by the Government. The process will have to be completed within 90 days which may be extended by a maximum 45 days.
Provisions of insolvency process apply to fast track insolvency. This will be an enabler for start-ups and small and medium enterprises to complete the resolution process quickly and move on.

The aim of the Insolvency and Bankruptcy code is to conclude the procedure within half of the default time period specified under the Code. The person or entity seeking the fast relief will have the onus on the process at set-off and that person or entity that sets-off the Fast-Track process must support that the case is fit to be resolved fast.

Thus who ever files the application for fast track process under Chapter IV (Section 55) of the IBC will have to submit the application along with the proof of existence of default submitted as evidence and in records available with an information utility or such other means as may be specified by the Board.

Voluntary Liquidation of Corporate
The Code provides for voluntary liquidation proceedings by corporate entities which wishes to liquidate itself and has not committed any default and can pay off its debts fully from proceeds of liquidation of its assets.
The law requires a declaration to that effect from majority of directors of the company also stating that the company is not being liquidated to defraud any person. A resolution passed to this effect shall be approved by creditors representing two-thirds value of the

company's debts. Voluntary liquidation commences when such resolution is passed by the creditors as above. Provisions of liquidation process apply to voluntary liquidation. Once the debtor is completely wound up and assets liquidated, the NCLT passes an order for its dissolution.

Order of priority of paying debts

The Code provides under Section 53 of IBC 2016, the priority with regard to distribution of proceeds following liquidation of the company or bankruptcy of individual or partnership as following:

- The insolvency resolution process costs and the liquidation costs in full;
- The following debts which rank equally:
  (i) workmen's dues for the period of 24 months preceding the liquidation commencement date; and
  (ii) debts owed to secured creditors in the event such secured creditor have relinquished its security to the liquidation estate;
- Wages and any unpaid dues owed to employees other than workmen for the period of 12 preceding the liquidation commencement date;
- Workmen's dues for earlier period;
- Financial debts owed to unsecured creditors which rank equally;
  (i) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;
  (ii) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
- Any remaining debts and dues that are pending;
- Preference shareholders, if any; and
- Equity shareholders or partners, as the case may be.

Key features of IBC

- To set a clear, coherent and speedy process for early identification of financial distress and resolution of companies and limited liability entities if the underlying business is found to be viable.

- "Fresh Start" and "Insolvency Resolution" — Two distinct processes for resolution of individuals.

- Debt Recovery Tribunal and National Company Law Tribunal to act as Adjudicating Authority and deal with the cases related to insolvency, liquidation and bankruptcy process in respect of individuals and unlimited partnership firms and in respect of companies and limited liabilities entities respectively.

- Establish an Insolvency and Bankruptcy Board of India to exercise regulatory oversight over insolvency professionals, insolvency professional agencies and information utilities.

- Insolvency professionals would handle the commercial aspects of insolvency resolution process. Insolvency professional agencies will develop professional standards, code of ethics and be first level regulator for insolvency professionals members leading to development of a competitive industry for such professionals.

- Information utilities would collect, collate, authenticate and disseminate financial information to be used in insolvency, liquidation and bankruptcy proceedings.

- Enabling provisions to deal with cross border insolvency.

CODE AND IT'S AMENDMENTS

Certain issues such as the proposed eligibility criteria for bidders have put a break on the capacity to help out creditors efficiently. The mandate of IBC is to lay emphasis on the strict time line for the resolution process. IBC has to balance the two objective of fast resolution and in maximising recovery for lenders. Thus there may be a requirement for longer duration of resolution process.

However, the IBC has been in focus for the respite it promises to various stakeholders and in its ability to expeditiously resolve the process of large amounts of non-performing assets and debts.

The government has on its part lent a patient hearing to all suggestions and has evaluated them on the basis of merit. The year 2017 and 2018, witnessed several legal and regulatory developments in terms of the Court's interpretation of the Code, modification to the Code to plug loopholes and fine tune it along with modifications to its allied laws.

An indication to its acceptance and success can be had from the number of applications

First Insolvency Resolution

- The first order under the code was passed by National Company Law Tribunal (NCLT) for the resolution process of Synergies-Dooray Automotive Ltd. on 14 August 2017
- The plea for insolvency was submitted by company on 23 January 2017. The resolution plan was submitted to NCLT within a period of 180 days as required by the code, and the approval for the same was received on 2 August 2017 from the tribunal. The final order was uploaded on August 14, 2017 on the NCLT website
- The total amount paid to financial creditors, operational creditors and after settling Government dues was ₹58.59 crores. Financial creditors got ₹54.69 crores against a claim of ₹972.15 crores, i.e. 5.6 per cent
- The second resolution plan was submitted for Prowess International Private Ltd.

filed for resolution and in their outcome and quantum of NPA to be resolved in the past two years.

The Bill prohibits certain persons from submitting a resolution plan in case of defaults. These include: (i) wilful defaulters, (ii) promoters or management of the company if it has an outstanding non-performing debt for over a year, and (iii) disqualified directors, among others. Further, it bars the sale of property of a defaulter to such persons during liquidation.

Insolvency Resolution - Performance Score Card

It is two years since the provisions relating to CIRP came into force nearly 1500 CDs have been admitted into CIRP by the end of December, 2018. Of these, 142 have been closed on appeal or review or settled; 63 have been withdrawn; 302 have ended in liquidation and 79 have ended in approval of resolution plans.

As per the ministry of Corporate Affairs estimates the NCLT has helped to resolve insolvency and bankruptcy proceedings involving ₹80,000 crore during the past year.

Large corporate houses such as Arcelor Mittal, Tata Steel, Reliance Industries, Ultra Tech Cement, Liberty Group from UK, Vedanta, Dalmia Bharat groups were amongst the leading companies who had submitted their resolution plans to acquire the debt ridden firms.

Corporate Insolvency Resolution Process **(Number)**

Quarter	CIRPs at the beginning of the Quarter	Admitted	Closure by				CIRPs at the end of the Quarter
			Appeal /Review / Settled	Withdrawal under Section 12A	Approval of Resolution Plan	Commence ment of Liquidation	
Jan - Mar, 2017	0	37	1				36
Apr - Jun, 2017	36	129	8				157
Jul - Sept, 2017	157	232	18		2	8	361
Oct - Dec, 2017	361	147	38		7	24	439
Jan - Mar,2018	439	195	20		11	59	544
Apr - Jun, 2018	544	245	20	1	14	50	704
Jul- Sept, 2018	704	235	30	26	32	83	768
Oct - Dec, 2018	768	264	7	36	13	78	898
Total	**NA**	**1484**	**142**	**63**	**79**	**302**	**898**

Source: *IBBI*

*These exclude 3 resolutions which have since yielded into liquidation Source: Compilation from website of the NCLT

Resolution of 12 large accounts has been initiated by banks as directed by RBI. Together they had an outstanding claim of ₹ 3.45 lakh crore as against liquidation value of ₹73,220.23 crore. Of these, resolution plan in respect of four CDs, namely, Electrosteel Steels Ltd., Bhushan Steel Ltd., Monnet Ispat and Energy Ltd., and Amtek Auto Ltd. have been approved. With regard to Lanco Infratech Ltd., liquidation order has been passed. Other accounts are at different stages of the process.

The outcome of four large accounts that ended with resolution plans is presented in the table below.

Four Large Accounts **(Amount in ₹ Crore)**

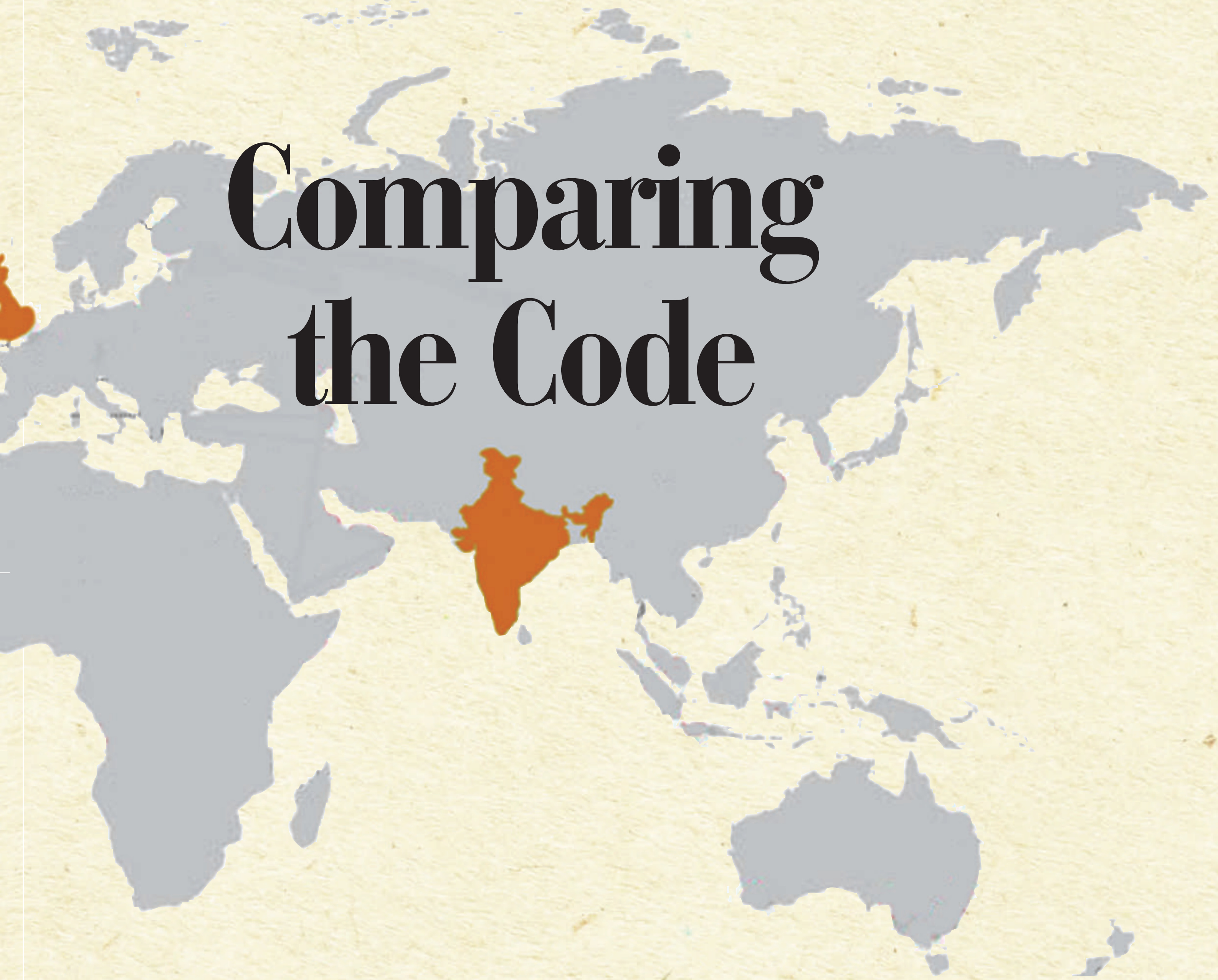
Corporate Debtor	Claims of Financial Creditors Dealt under Resolutions Dealt under Resolutions			Realisation by all Claimants as a % of Liquidation value	Successful Resolution Applicant
	Amount Admitted	Amount Realised	Realisation as % of Claims		
Electrosteel Steels Ltd.	13175	5320	40.38	183.45	Vedanta Ltd.
Bhushan Steel Ltd.	560226	35571	63.50	252.88	Bamnipal Steel Ltd.
Monnet Ispat & Energy Ltd. Pvt. Ltd.	1 1015	2892	26.26	123.55	Consortium of JSW and AION Investments
Amtek Auto Ltd.	12605	4334	34.38	106.20	Liberty House PTE

Source: *IBBI*

Source : Press Information Bureau, the Times of India, The Economic Times, IBBI

Majority of legal systems in Commonwealth countries are found and based on common English Law. For India too, it has an influence in formulating the Insolvency and Bankruptcy Code

Comparing the Code



It may be of interest here to examine the practice of recovery in other countries. Some of these practices have influenced our laws pertinently.

The corporate insolvency laws of most legal systems are widely categorised to be either 'debtor-friendly' or 'creditor friendly'. Laws in United States, France and Italy are perceived as benefiting debtors more than creditors, while in case of UK, Sweden and Germany the law is seen to favour creditors.

Reorganisation or rescue provisions of an insolvency regime are generally considered to favour the debtors. Liquidation, on the other hand, is largely assumed to be a process that primarily protects the creditors. Nevertheless, studies have shown that the success or failure of an insolvency regime is not a function of which side of the friendliness spectrum a given systems falls in, but is rather dependent on the legal institutions within which the system operates, as well as the nature of the firms that the law services, and their capital structure.

A majority of legal systems in Commonwealth countries are found and based on common English law. For India too, there has been an influence in formulating the Insolvency and Bankruptcy Code in India. Hence, it is not a surprise that the Code is said to be similar to the UK Insolvency Regime.

However, the Bankruptcy Law Reforms Committee made a commendable effort in framing the code befitting the Indian scenario. The implementation of the Code has helped India to move up from its current rank of 130 in the World Bank's ease of doing business index.

The key feature of the Indian code is the move from the existing 'debtor in possession' to a 'creditor in control' regime — a decision well taken by the Bankruptcy Law Reforms Committee. This is similar to UK's 'creditor in control' and is one of the most globally established and recognised feature.

KEY SIMILARITIES BETWEEN IBC, 2016 AND UK INSOLVENCY REGIME

Creditors drive the procedure; authorised Insolvency Professionals run the procedure

When a borrower defaults, a creditor can record and file an application to the court to begin the indebtedness procedure. Here creditors are in charge in deciding future strategy of the company. An authorised insolvency professional runs the procedure.

Any creditor or the debtor can initiate the process

Just as a creditor can initiate the insolvency process in the event of default, the debtor, too, can initiate the process by making an application to the court. The process is majorly similar.

Moratorium provided during the insolvency period

Upon commencement of the insolvency resolution process, a moratorium will be available to the corporate debtor. During this period, no suits can be filed or recovery action can be initiated against the debtor.

Clear waterfall of payments outlined during liquidation

Under both the UK and the Indian law, the legislation provides a clear waterfall of payments during liquidation. The priority of payment is given to secured and preferential creditors. During liquidation, the liquidator pays the liquidation costs first before making payment to any preferential or secured creditors.

Multiple IPAs (or equivalent) regulated by a Board

In the UK, there are multiple self-regulating bodies including ICAEW, ACCA and ICAS. Any professional who wishes to become an insolvency professional requires to register with such a body and pass an exam. He has to put in minimum hours of practical training. There is a common board which oversees functioning of all the self-regulating bodies and brings in consistency in their functioning.

In India as well, the draft regulations provide for multiple IPAs to be formed under the IBBI.

DIFFERENCES

Creditors' inclusion amid the bankruptcy procedure

In the UK, the insolvency professional is an officer appointed by the court. Once the compensation is endorsed by the creditors, the professional is not required to take any further approval from creditors in administration of operations of the company in the indebtedness time frame. However, there are different activities for which the professional requires earlier approval from the creditors. In India, creditors have a larger role to play in the bankruptcy procedure.

Performance security or bond to be provided by the IP

In the UK, insolvency professionals are required to provide a general and a specific bond based on the value of assets involved under the case. The bond is to cover a situation, if any fraudulent act is committed by the professional.

The provision for a bond was initially specified in the draft of the Insolvency and Bankruptcy Code submitted to the JPC. This was removed in the final draft that got enacted.

Voting rights of creditor classes:

In the UK, all creditors, including trade creditors (not secured creditors) to the extent of the value of their security, have voting power in the creditor committee in the proportion of the outstanding sum, especially in case of a resolution design.

In India, financial creditors, either secured or unsecured, can vote in creditor committee. However, they have to guarantee that at least 'liquidation value' is given to the operational creditors during any resolution. In India, 66 per cent of the financial creditors in value terms require to approve the resolution design proposed amidst the bankruptcy procedure. In the UK, creditors with a minimum majority can affirm a resolution plan.

Deadline for the completion of the insolvency resolution process

The Code specifies that if a resolution plan is not approved by the creditors within 180 days, or during the extended 270 days, the liquidation process would automatically be triggered.

In the UK, no such timeline has been specified under the law.

Remuneration of liquidator and timeline for completion of liquidation

In the UK, remuneration for the IP in liquidations is generally decided based on discussion between the creditors and the IP, taking into account the time spent, assets realised, complexity of the case etc. If a consensus cannot be reached, the court fixes the remuneration.

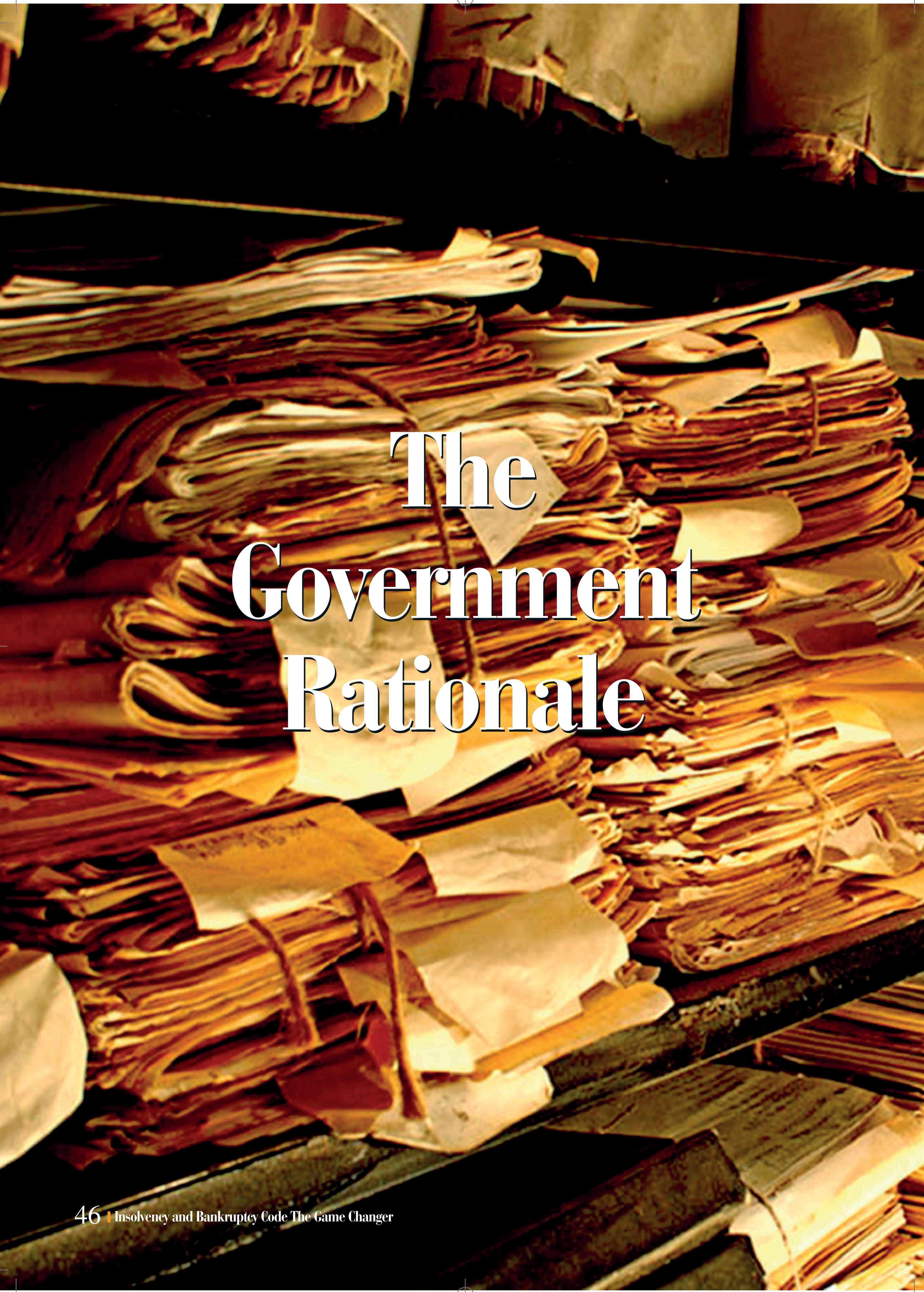
In India, the liquidation remuneration could be decided by the creditors in certain circumstances while in other cases, it would be decided based on the scale of realisation and distribution. IBBI has prescribed a path containing the fee based on quantum of recovery and time of recovery. Also, according to the draft regulations, the liquidator is required to liquidate the assets within two years.

There is no such necessity in the UK for the liquidator.

Comparison with the US law

The Indian reorganisation and liquidation regime gives priority to the interests of the creditors over that of the shareholders and other stakeholders.

In the US, there is no requirement of proving insolvency for a company in order to prove insolvency to undergo rescue procedures under Chapter 11 of the Bankruptcy Code. On the contrary, the US law uses the insolvency or likelihood of insolvency of a company as a trigger to invoke administration (the formal process for revival and rehabilitation of companies) under financial distress. Since doubtful solvency is often an indicator of impending financial troubles, such a test is best suited for determining whether steps for rehabilitating the company are to be taken.



The Government Rationale

A single and simplified legal frame work was long overdue to address the process of resolution of stressed assets. Through the Code, the sole intention was fast track proceedings to unlock non- performing assets and pay off creditors and bring back locked up money to be used productively elsewhere

Indian industry for long has been through times of distress as a number of factors have always dominated their performances. One major factor has been their inability to pay debts to lending financial institutions for reasons many and unique as per industries. The mammoth size of non-performing assets began to show up from 2015. Bad loans in India held back economic growth despite the much publicised projects by the government to grow at a faster pace. A number of reasons have been attributed to the slow down primary amongst then have been the slowdown in the global markets, lack of demand for products and services at home and domestic markets and the spike in oil prices that affected global trade. As a result India Inc had a lack lustre performance and pulled down banks with higher defaults. The gross NPA ratio has moved up from 5.9 per cent in 2015 to 9.6 per cent in 2017 as a combined effect of these factors.

> Attempts to recover bad loans from industries have been very fragmented with an ineffective law regime governing insolvency and bankruptcy proceedings. Thus, a number of policies, laws and regulations have been framed time and again to contain the growing menace of non-performing assets that have made industries sick

The Financial Resolution and Deposit Insurance (FRDI) Bill was the latest attempt at mopping up the bad loans with which banks are saddled with. Previous attempts to this end have been moderately successful.

More recently, in an effort to recover outstanding loans, a slew of legislations including the Insolvency and Bankruptcy Code, the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, and the Recovery of Debts due to Banks and Financial Institutions were instituted. Debt Recovery Tribunals were also set up to fast-track proceedings.

The implementation of the Insolvency and Bankruptcy Code was brought in with the sole intention of fast track proceedings for unlocking stressed assets and paying off creditors, which in many cases were banks, and to bring back locked up money to be used productively elsewhere. This would take off much of the burden from banks that are saddled with massive bad debts.

Efforts were made within the banking system by the Reserve Bank of India to come out with various policies of resolution. Some of them were well intended — by giving leeway to the debtors by providing time extension for restructuring the debt, instead of literally forcing them out of business. But all that it did was that they ended up in ever greening debts. This led to situations where even the financial institutions as creditors kept concealing, not from the country, but from themselves to what the real debt situation was. The effect of all those policies was that the debt ultimately turned out to be almost four times of what was disclosed. Or, the NPAs were almost four times of what was disclosed in the books. And, therefore it unfloded a larger problem than actually perceived.

A reformation such as IBC, therefore, had to be enacted as a fast-moving exercise and it had to be enacted out of necessity since every other earlier effort towards providing a effective solution platform had effectively failed. The drafting committee, headed by

T K Viswanathan, did a fascinating job in a short period at their disposal. They studied the global models and came out with a report which was subsequently converted into a legislation that was swiftly put it in place, in spite of no prior experience of an exit law or an insolvency law. Its effectiveness was tested when it was put into action. Since its enactment little over two years ago, the law was changed twice to make it more effective and bring it at par with market realities.

As the finance minister observed, the government has, through the implementation of the Code, envisaged to simplify various laws and help resolve disputes in a time-bound manner. IBC identifies the sustainability issue. The primary intention of the Code is to "take timely decisions."

Through its introduction the objective was to maximise value through a time bound effective solution and get rid of NPA issues of the banks. The major changes it brought about were through its effective implementation, having a separate adjudicating authority, setting a time bound process, giving creditors the privilege and placing government dues as subordinate to secured creditors, among others.

The success of the process can be gauged from the numbers of companies that have settled their dues. Fearing action under the newly-enacted Act, over 2,000 companies with default loan repayments have settled dues.

A majority of these amounts was cleared after the government amended IBC norms to prevent promoters of companies, whose accounts have been classified as non-performing assets, from bidding to regain management control.

The amendments have also aimed to keep out wilful defaulters associated with non-performing assets — the habitual non-compliants. They are perceived to be a great threat to a successful resolution of insolvency process. Also to restrict such persons to participate in the resolution or liquidation process, the amendment also provides checks by stating that the committee of creditors can ensure the viability and feasibility of the resolution plan before approving it. In the recent past, a number of companies who had filed petitions before NCLT withdrew applications before they were admitted. This indicates that most of these companies preferred an out-of-court settlement. Earlier, the issues remained unresolved for years under the Civil Code.

Once a company files for insolvency with NCLT or the Debt Recovery Tribunals, the management of the company is taken over by the resolution professional, who would try and resolve the issue so as to let business continue. The liquidation process would begin only if the resolution professional was not hopeful of reviving the company.

Chapter 3

Industries under Strain

The advent of the Code has created the right ripples to help restructure and reorganise bad debts in Indian industries

Stressed assets in Indian industries have had a cancerous growth over a period of time. Lack of proper and structured laws and policies have allowed bad debts to eat into lenders' funds to an extent that many face crippling blows now.

Indian industry has had a common malady across all — it has had borrowings at a rather high rate against technology and products that have failed to a large extent to attract buyers across. There have been other impelling reasons too. High logistic costs for transportation of goods and services, lack of insight in framing policies, land acquisition issues and the whole lot have been major hindrance to planned growth of industries making them less competitive.

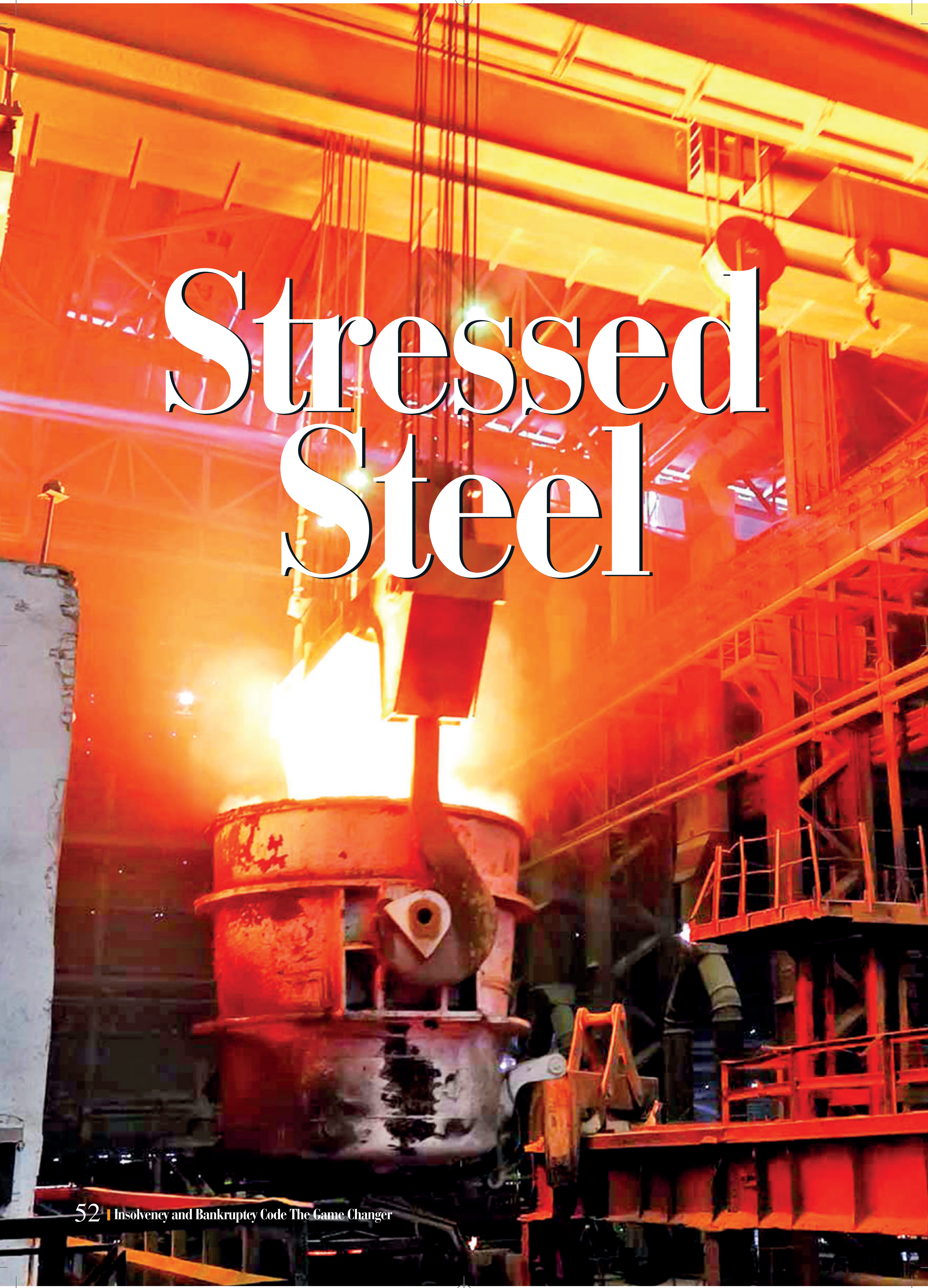
It is estimated that non-performing asset recognition is likely to get prolonged till the next fiscal year. This may put ₹5.24 trillion of debt in financial year at risk and increase the bad loan stress.

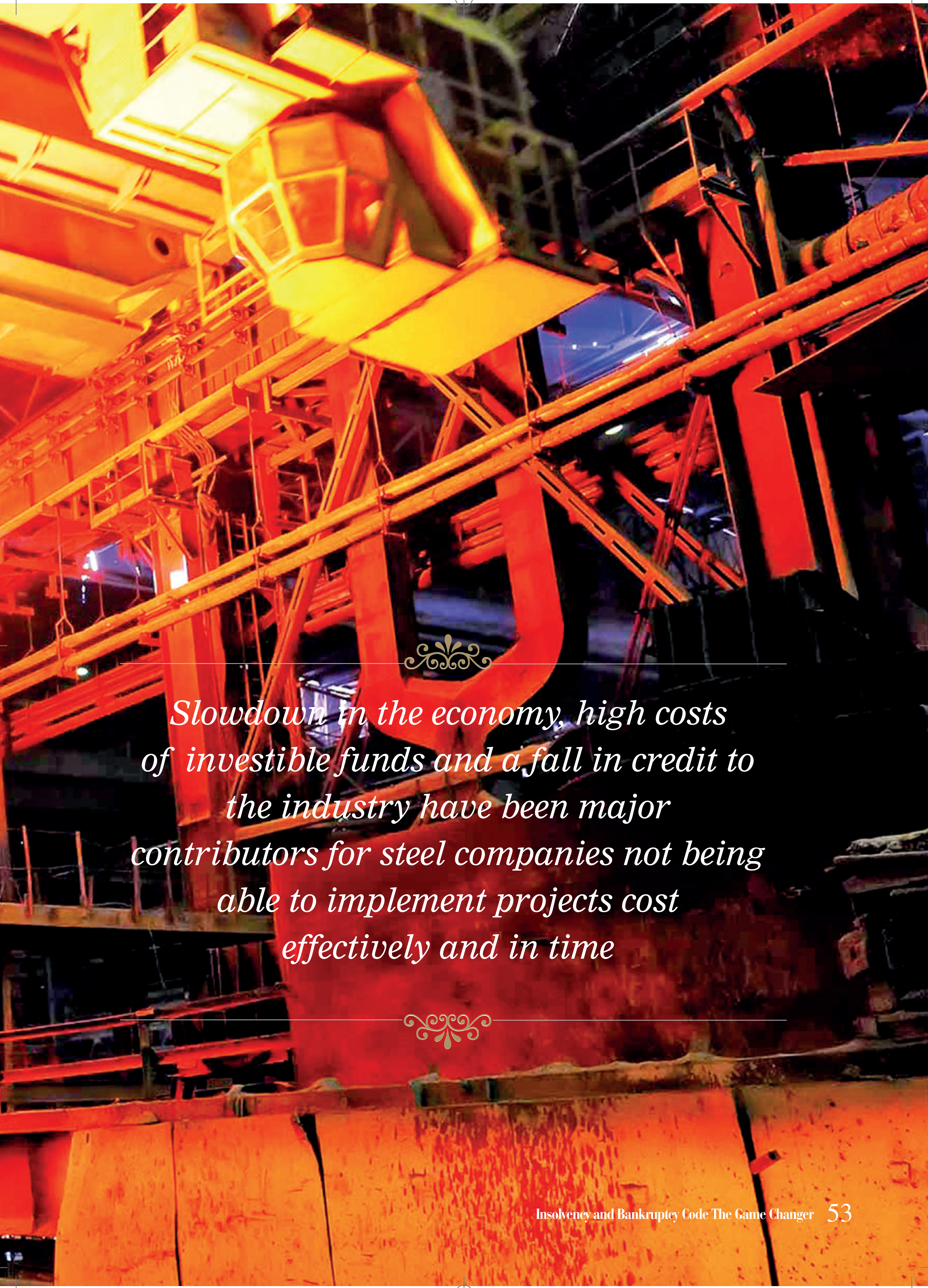
The introduction of the Insolvency and Bankruptcy Code has been in operation for the past more than two years and has surely created the right ripples to help restructure and reorganise bad debts in industries. Though it is still evolving and in a learning phase, it leads to a promise to resolve bad loans.

The Indian industry now looks at restructuring and reorganising its assets quality to create a platform to begin afresh. This is of paramount importance for the development of business and commerce in India particularly in the years to come. The major industries such as steel, power, construction have had their bad days with bad debts.

The recent effort to restructure debt ridden companies in India now involves some of the nation's biggest companies, including Reliance Communications Ltd., Essar Steel Ltd. and Bhushan Steel Ltd. Many of large cases are running behind schedule because of a great variety of reasons that includes shortage of judges to legal challenges. However, once resolved they would offer a unique opportunity for a fresh beginning.

Stressed Steel





Slowdown in the economy, high costs of investible funds and a fall in credit to the industry have been major contributors for steel companies not being able to implement projects cost effectively and in time

India is the second largest producer of steel in the world. Being a core sector, it influences economic growth of the country immensely. The data of per capita consumption of steel is used to create crucial index for measuring the socio-economic development of the country.

Thus a build up of stressed assets in the industry has a direct impact on the performance of the country's economy as a whole.

Market Size Of Indian Steel Industry

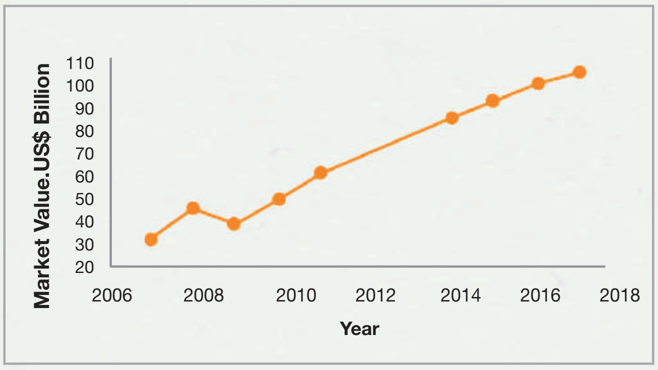
- Steel sector contributes over 2 per cent to the GDP
- In 2017-18, production of Crude Steel in India was 103.13 million tonnes.
- Between FY 2010-18, the crude steel and finished steel production of the country has grown at a CAGR of 5.77 per cent and 7.11 per cent respectively.
- The consumption of finished steel was 90.71 MT in 2017. It grew at a CAGR of 5.45 per cent between FY10-18.

Domestic Scenario

The Indian steel industry has entered into a new development stage, post de-regulation, riding high on the resurgent economy and rising demand for steel.

Rapid rise in production has resulted in India becoming the 2nd largest producer of crude steel during the year 2018, from its 3rd largest status in 2017.

Exhibit 1: Market Value, Indian Steel Sector, 2007-2017



Source: IBEF, Joint Plant Committee, LSI Research

Exhibit 2: Other factors, which have made Indian Steel Industry outstanding, 2007-2017

- Largest producer of sponge iron in the world
- 2nd largest producer of crude steel in the world
- 2nd largest consumer of finished steel in the world
- Production of world-class steel of all major varieties/ grades

The country is also the largest producer of sponge iron or direct reduced iron in the world and the 3rd largest finished steel consumer in the world after China and USA.

In a de-regulated, liberalised economic market scenario like India, the government's role is that of a facilitator which lays down the policy guidelines and establishes the institutional mechanism/ structure for creating conducive environment for improving efficiency and performance of the steel sector. In this role, the government has released the National Steel Policy 2017, which has laid down the broad roadmap for encouraging long term growth for the Indian steel industry, both on demand and supply sides, by 2030-31. The said Policy is an updated version of National Steel Policy 2005 which was released earlier and provided a long-term growth perspective for the domestic iron and steel industry by 2019-20.

The government has also announced a policy that emphasises the preference of home manufactured iron and steel products in its procurement. This policy seeks to accomplish the government's vision of 'Make in India' with objective of nation building by encouraging domestic manufacturing. It is thus applicable on all government tenders where price bids on all government tenders to be opened. Further, the Policy provides a minimum value addition of 15 per cent in notified steel products that are covered under preferential procurement. In order to provide flexibility, the Ministry of Steel may review specified steel products and the minimum value addition criterion.

Global Scenario In 2017

World crude steel production reached **1690** million tonnes (mt) which is a growth of **4%** over 2016

CHINA 832 (MT)

JAPAN 105 (MT)

INDIA 101.4 (MT)

USA 82 (MT)

World Steel Association has projected Indian steel demand to grow by 7.5 per cent in 2018 and by 7.3 per cent in 2019, while globally steel demand has been projected to grow by 3.9 per cent in 2018 and by 1.4 per cent in 2019. Chinese steel use is projected to grow by 6 per cent in 2018 and showed nil growth in 2019.

Per capita finished steel consumption in 2017 is placed at 212 kg for world and 523 kg for China by World Steel Association. The same for India was 69 kg in 2017.

Production

- Steel industry was de-licensed and de-controlled in 1991 and 1992 respectively.
- India is currently the 2nd largest producer of crude steel in the world.
- In 2017-18, production of total finished steel (alloy + non alloy) was 126.85 MT, a growth* of 5.6 per cent over last year *(* Prov).*
- Production of Pig Iron in 2017-18 was 5.73 MT, a decline of 45 per cent over the previous year.
- India was the largest producer of sponge iron in the world. The coal based route accounted for 79 per cent of total sponge iron production (30.51 MT) in the country in 2017-18.

Indian Steel Industry : Production (in Million Tonnes)

Category	2013-14	2014-15	2015-16	2016-17	2017-18	April-Nov (2018-19)
Pig Iron	8.35	10.23	10.24	10.34	5.53	3.94
Sponge Iron	22.87	24.24	22.43	28.76	30.51	19.62
Total Finished Steel	99.38	104.58	106.60	120.14	126.85	85.96

Source: Joint Plant Committee

Demand - Availability

Industry dynamics including demand and availability of iron and steel in the country are largely determined by market forces and gaps in demand-availability are met mostly through imports. Interface with consumers exists by way of meeting of the Steel Consumers' Council, which is conducted on a regular basis. Interface helps in redressing availability problems, complaints related to quality.

Steel Prices

Price regulation of iron and steel was abolished on January 16,1992. Since then, steel prices are determined by the interplay of market forces. Domestic steel prices are influenced by trends in raw material prices, demand–supply conditions in the market, international price trends among others.

An Inter-Ministerial Group (IMG) is functioning in the Ministry of Steel, to monitor and coordinate major steel investments in the country. As a facilitator, the government monitors the steel market conditions, based on which it adopts fiscal and other policy measures.

Currently, GST of 18 per cent is applicable on steel and there is no export duty on steel items. The government has also imposed export duty of 30 per cent on all forms of iron ore except low grade, (below Fe 58 per cent). Iron ore lump and fines and iron ore pellets have nil export duty.

In view of rising imports, the government had earlier raised import duty on most steel items twice, each by 2.5 per cent. It imposed a gamut of measures including anti-dumping and safeguard duties on a host of applicable iron and steel items.

In a further move to curb steel imports, the government banned the production and sale of steel products that does not meet Bureau of Indian Standard approval. It also laid a check on the sale of defective and sub-standard stainless steel products used for making utensils and kitchen appliances. It issued the Stainless Steel (Quality Control) Order, 2016 for products used in making utensils and kitchen appliances. This helped filter imports of the metal. Again, in February 2016, the Indian Government had imposed the Minimum Import Price (MIP) on 173 steel products. The MIP was extended thrice and ceased to be effective from February 2017. Currently, a mix of anti-dumping / safeguard and other measures are in place on a range of steel items to control the inflow of cheap steel. Further, a Steel Price Monitoring Committee has been constituted by the government with the aim to monitor price rationalisation, analyse price fluctuations and advise all concerned regarding any irrational price behaviour of steel commodity.

Import

Iron and steel can freely be importable as per the Extant Policy.

Indian Steel Industry : Import of Total Finished Steel (in Million Tonnes)

Category	2013-14	2014-15	2015-16	2016-17	2017-18	April-Nov (2018-19)
Qty	5.45	9.32	11.71	7.23	7.48	5.24

*Source: Joint Plant Committee * Prov*

Exports

- Iron and Steel are freely exportable
- India emerged as a net exporter of total finished steel in 2016-17 and 2017-18
- Data on export of total finished steel (alloy/stainless + non-alloy) is given below for last five years and April-November 2018-19 (Prov). :

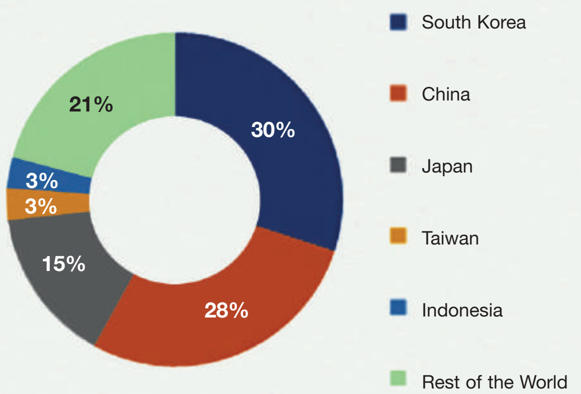
Indian Steel Industry : Exports of Total Finished Steel (in Million Tonnes)

Category	2013-14	2014-15	2015-16	2016-17	2017-18	April-Nov (2018-19)
Qty	5.99	5.59	4.08	8.24	9.62	4.08

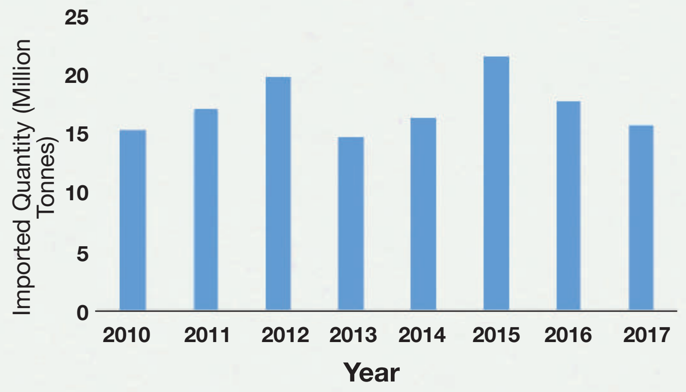
*Source: Joint Plant Committee * Prov*

Despite the fact that the Indian steel industry's presence in the global and domestic markets seem to be increasing, it is saddled with a huge burden of bad loans. It is estimated that till June 2018, out of the gross NPA of Indian banks of more than ₹10 lakh crore, the steel industry had a share of about 10 per cent.

TOP 5 STEEL IMPORTERS TO INDIA, 2017



TOTAL IMPORTED QUANTITY OF IRON & STEEL IN INDIA FROM THE OTHER COUNTRIES, 2010-2017



***Source** : International Trade Administration, Intracen, LSI Research*

Reasons For The Growing Stress In Steel Industry

Low Commodity Prices: Along with the fall in the crude oil prices for its excess supply, price of other commodities also shifted downwards in 2015. Slow growth in China was a major factor for lower price of steel and other commodities.

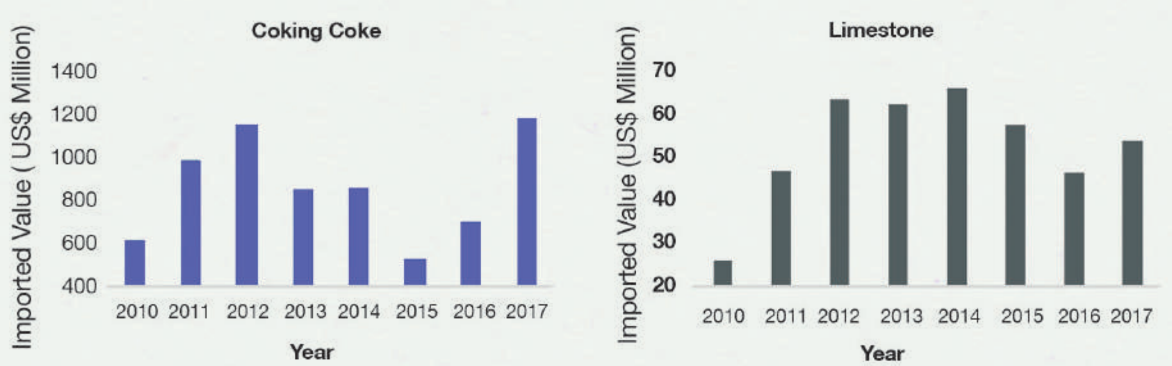
Falling Demand Overseas: Growth in demand from large consumer countries such as China tapered off affecting imports from countries such as India. Statistics reveal that the Chinese investment growth slipped from 10 per cent on an average to about 7.4 per cent. As per an IMF report the share of investments was 48 per cent of Chinese GDP — far greater than the regular investment rate by the other countries of about 15 per cent. So the fall in the Chinese markets directly affected commodity prices. Being big, the fall in the country's economy was enough to hit global commodity prices. Falling prices reduce profit margins of steel producers everywhere, including India.

Global Overcapacity: Dumping of excess steel and steel products produced by countries like South Korea and China has always mattered in the Indian markets. India has been a ready market for their products for import. Their steel products were of better quality and cheaper in price than those made in India. This rubbed off the domestic manufacturer's profit margins for they too lowered prices to remain in business.

Power Problems: Uninterrupted supplies of quality power to industries has always been a sore in the country's industrial growth. India has faced a major problem of power scarcity, since long because of various reasons. Low availability of high calorific value coal domestically has been a major concern for all thermal power plants. Along with these, high costs of imported coal and machinery, low generation of power from renewable sources contributed to making situations difficult to produce quality power.

Inferior Raw Material Quality: Availability of coal, iron ore and other raw materials required to manufacture steel is scarce. Mining also faces stringent environment laws and strictures and does not allow free use of natural resources. Imports of coking coal and limestone has gone up, so have been their prices abroad. Over the years, the amount invested in import of the raw materials like coking coal has increased at a CAGR 9.7 per cent. In case of limestone, it has been at a CAGR of 11 per cent. The overall impact of high imports has raised costs of production.

Imported Value of some of the raw materials used for the steel production in India, 2010 -2017



Source : Intracen

Delay In Project Implementation : Iron and steel industry is one of the main pillars of the economic growth. Here, best quality of raw materials, advanced and cost effective technologies constitute an integral part of the whole ecosystem in which industries grow. However, as stated above, delays of implementing projects in steel have been because of the various reasons stated. The slowdown of the economy, high costs of investible funds and a fall in credit to the industry have also contributed majorly to its slowing down.

But the biggest drawback for steel companies has been their inability to implement projects in time and thus without cost over runs. Added to this, complexities of land

acquisition process in India also makes it difficult sometimes for the companies to acquire suitable sites for setting up production units. Several other regulatory hurdles, such as grants of mineral concession, environmental clearances, delay the project implementation.
The cumulative effect of all of the above factors have eroded the post tax profit levels of most of the major players in the industry — for both the PSUs and private corporate.

Falling profits have led to rapidly rising debt burden in the industry. During the period of boom in the economy, many steel companies embarked on large expansion plans having been financed by debts, predominantly through bank loans. The growth of bank credit to the iron and steel industry peaked to over 30 per cent in 2011. Since this coincided with a period when the Reserve Bank of India was raising interest rates, a combination of rising debts and interest rates led to major companies failing to service debts.

Growth in the industry has thus been on the decline under the dual pressure of rising debt-service burden and the fall in bank credit growth. Banks became wary of lending to companies for the fear of spiking up bad loans in their balance sheets. Thus, the growth of bank credit to iron and steel industry fell to an all-time low of 2.5 per cent in 2017, as many players were unable to service their debt on time. This led to a large number of companies opting to take the route to corporate debt restructuring. With the total debt of ₹39,770 crore, the iron and steel industry accounted for 22 per cent of the total debt under CDR cases in the country as of March 31, 2017. According to the RBI's financial stability report of 2016, steel sector is the second most debt-ridden — a situation that may not be easily overcomed in the immediate future.

Setting the stage for steel tycoon LN Mittal's entry into the Indian steel industry decks have now been cleared for ArcelorMittal and Nippon Steel's ₹42,000 crore offer to take over debt ridden Essar Steel.

On the Cusp of a Structural Transformation – The Indian Bankruptcy Code and the Steel Industry

Atanu Mukherjee

President, M N Dastur & Co (P) Ltd.

The introduction of the Indian Bankruptcy Code, and the recent resolution of some of the large bankruptcies in the Steel industry is a landmark and welcome step towards the speedy resolution of the bad loans crisis, which has been festering for years.

As is the case with all large systemic bad debt situations, the current NPA mess did not happen overnight. The genesis of the problem started way back in 2003-2004, when the Indian economy went on a growth overdrive for close to a decade. In a developing country, such growth attracts large investments typically through debt financing, especially in capital intensive sectors like steel. In the absence of deeper debt markets, the only large-scale debt financing institutions in India are the public sector banks with SBI leading the pack. Such concentration of debt in exuberant environments, when combined with implicit charters to fund industrial investments for the nation and under a rather accommodating regulatory environment is a cocktail for risky lending. Typically, in such scenario's credit worthiness assessment, risk analysis, monitoring and governance goes out of the window and it often leads bankers and financers to chase promoters in many cases, rather than the other way around. In India, the resulting industrial credit boom driven by the public sector banks pushed credit growth to unseen levels of 25-30 per cent per year in the first decade of the millennium. Easy industrial credit and the absence of rigorous bankruptcy law or enforceable debt resolution system further encouraged many promoters to undertake exuberant debt financed investments, many of which were neither rational nor prudent. In the steel sector, many such investment decisions had been made without giving adequate considerations to long term profitability, degree of leverage, appropriate plant designs, product mix flexibility, supply chain flexibility and to the maturity in operating practices. These foundational shortcomings not only created intrinsic barriers to the competitiveness and sustainable profitable operations of these firms, but also left them unprepared to withstand any demand shocks or downturns. As it happens, a rising tide hides all the rocks and the intrinsic unsustainability of many of these businesses lay hidden – until the twin shocks of softening demand and global excess capacity in steel industry started unravelling in 2013.

When the market situation changed, the limited resilience of many of the steel companies resulted in EBITDA levels dropping by more than 50 per cent. As a significant portion of the debt heavy steel company's cash-flows were being used to service the debts, most of these steel firms could not withstand the shock and that was the start of the sustained bleeding. Further, the built-in disincentives of the PSU banks to recognise NPAs, led to the evergreening of the loans with the expectation that the wounds would heal over time and good times will eventually return. This led to more good money chasing bad money postponing the inevitable mess leading to the NPA crisis in the steel industry that we all see today.

Bankruptcy is a part and parcel of a progressive, dynamic and vibrant industrial society. The ongoing distressed asset crisis at hand is in fact a terrible opportunity to waste.

The Indian Bankruptcy Code has certainly been a commendable and credible legally enforceable initiative in starting the resolution of the large scale NPA problem in the Indian steel industry. While a few very large steel assets have been resolved successfully, the nascent state of the IBC laws are still evolving as the resolutions are being worked. We must understand that the auction-based resolution to the highest bidder that we have seen till date, is not necessarily the only way to resolve bankruptcies where multiple stakeholders are involved and where long-term preservation of economic value is a primary objective. This results in a situation where the prized larger assets sell for a premium with lesser haircuts, but the vast majority of the smaller assets may land up with a bid resulting in major haircuts or in liquidation. Many of the underlying physical assets of these smaller distressed steel firms are productive high-quality assets and have substantial opportunity to create value if organised and operated in the right way. Value destructive liquidations is the least desirable option because the price that the distressed assets fetch in a liquidation sale is much below the values they would command when put to best use. This results in large haircuts to the lenders weakening their balance sheets further, credit contraction, more recapitalization demands - and importantly – large but avoidable social costs. Careful consideration to creditors interest, stakeholders' interests, synergies with other assets, intrinsic values and long-term economic returns should play a key role in bankruptcy resolution – not just the highest bid.

Apart from auctions, cooperative bargaining-based strategies aided with expert advice, sector specific interim asset warehousing and disposition, and pre-packaged bankruptcies could result in more pragmatic and faster resolutions while creating more value. We have seen that IBC based bankruptcy resolution are litigation prone and takes a long time to resolve while being simultaneously an expensive process. We must also have less expensive and quick out-of-the-court resolution mechanisms to supplement the IBC process for distressed asset resolutions so that all classes of assets can be resolved effectively. Not all distressed assets need to land up in the bankruptcy court — and given the scale of NPAs, this may quickly overwhelm our bankruptcy resolution institutions like the NCLT. In fact, the credible threat of IBC based filing can be used to move most of the distressed asset situations for out-of-court resolutions.

However, the biggest impact of a progressive distressed asset resolution process and the IBC in my opinion is the potential for induced structural transformation, and industry wide efficiency increase in the Indian steel industry. The bankruptcy resolutions offer the unique opportunity for Indian steel markets to consolidate, increase concentration and scale and become structurally sound over time. Historically, the vast majority of India's steel industry has been composed of the less capitally intense secondary steel sector whose smaller scale induction furnace and coal based sponge iron units did not necessarily have the scale or the operational efficiencies to support a sustainable stand-alone business in the long run. At the same time, many of the larger integrated steel plants were built on unsustainable leverage through bank debts. The bankruptcy-based restructuring of these distressed assets is driving the structural transformation of the industry through M&As and buyouts is creating more concentrated and productive capacity. With large multinational steel makers, many of whom have experience in India as well as critical global markets, there is an opportunity to increase the global reach of the acquired firms. Similarly, it is likely that the world-class acquiring company will be applying the best of management practices and technology to improve the operations and profitability of the acquired firm. There is also substantial automatic de-risking of operations of the acquired firms due to synergies and global scale.

Till date, IBC based restructuring has resulted in mergers and acquisitions of 20 mtpa of distressed capacity valued at over ₹140,000 Crores in distressed debt. Larger capacities like BSL, BPSL, Essar, Electrosteel and Monnet have either been acquired or are close to being resolved through the IBC, and more than 100 smaller scale induction furnace based units have either been absorbed or have exited in the last two years. As a result, the industry concentration ratio has moved up a healthy 5 per cent points to 48 per cent post these mergers and will likely move much beyond 50 per cent as the larger opportunities for consolidation in the smaller scale secondary steel sector materialise over the next few years.

Bankruptcy driven consolidation is thus an important step that is removing the structural impediments by increasing concentration, market power, productivity and industry margins while setting the stage for competitive and efficient industry expansion. Consolidation aids the much needed pure operational efficiency play required in the Indian steel industry, which can result in a more oligopolistic and reasonably profitable industry with a steeper industry cost curve while simultaneously increasing the consumer benefit by pushing the cost curve down.

While consolidation through bankruptcy can improve market concentration, productivity and margins, it may postpone new investments in large-scale capacity additions in the medium term as investments in the acquired capacities are fully integrated. At the same time, as the bankruptcy resolutions also clean the bank balance sheets and signal confidence in the investment communities, credit markets and debt markets will eventually broaden and deepen and this will open up avenues for investments in more intelligent, balanced and productive capacity growth for the longer term. In the interim however, we should temper our expectations as debt haircuts and uncertainty over resolutions and resulting bank recapitalizations can continue to make credit availability a challenge. This could result in a sharp gap between funding requirement and availability in the short term, and could further exacerbate the capacity postponement effect. Over the next decade as India continues to invest in infrastructure, it is likely that the dynamics of consolidation, productivity, financial markets, trade and investment propensities for greenfield steel plants will play out in a way to optimally allocate the required steel capacities for India. This hopefully will be in line with the national goals of Indian steel capacity growth.

There is a saying that capitalism without bankruptcy is like a religion without the concept of hell. Bankruptcy is thus a part and parcel of a progressive, dynamic and vibrant industrial society. The ongoing distressed asset crisis at hand is in fact a terrible opportunity to waste. We must use this opportunity to do things right, focus on the right priorities and galvanise the political will and resolve to take these large number of bankruptcies and distressed asset resolutions to their logical conclusions. We have a good chance that the majority of the firms get restructured and revitalised, the industry becomes structurally sound, banks start lending and the economic growth reignites to touch 8-10 per cent levels over the next few years. With so much at stake, failure is not an option.

Atanu Mukherjee

He is President of M N Dastur & Co. (P) Ltd. He has been consulting for metals, mining and energy industry globally in areas including strategy, technology, operations and finance. He works at the highest levels with national and international metals and mining firms and interacts at the apex levels with the Governments and the national and international institutions on industrial strategy, asset restructuring, energy, environment and policy. Over the last three years, he provided the leadership in helping shape the restructuring and viability of around 20 BB$ of stressed steel assets in India. In the recent past, he has been working with the US Department of Energy and Govt. of India on the policy, technology transfer and economics of coal gasification and related carbon capture mechanisms for steel, power and chemical industries in India. Atanu also advises international private equity firms and investors on asset revitalisation, M&As and investment strategies for steel and energy related businesses in North America.

Atanu holds a joint graduate degree in Engineering and Management from Massachusetts Institute of Technology's School of Engineering and The MIT Sloan School of Management. He was also a Research Fellow at MIT's Computer Science and Artificial Intelligence Laboratory where his team's pioneering research laid the groundwork for powering core components of today's Internet infrastructure. He has several publications in international refereed journals and holds multiple patents.

Atanu is a member of the Association for Iron & Steel Technology, Indian Institute of Metals, American Economic Association, American Finance Association and INFORMS. He is a visiting faculty at the Indian Institute of Management and frequently writes and speaks in the areas of Asset Restructuring, International Trade and Finance, Energy & Environment, Iron & Steel and Raw Materials. He was elected to the World's Who's Who in Science and Engineering.

We acknowledge his contribution and are thankful for the same.

Problems in Power

Reviving stressed assets in the power sector will be key in meeting future demands and paying debts

The setting up of an empowered committee headed by cabinet secretary P K Sinha by the government is an attempt to resolve the growing menace of stressed power projects. The committee will look into various factors that have led to formation of the non-performing assets and will attempt to resolve them and maximise the efficiency of investment.

It will also look into changes required in fuel allocation, regulatory framework, mechanisms to facilitate sale of power, ensure timely payments, payment security

DEBT OVERLOAD

OUTSTANDING LOANS OF 27 POWER PROJECTS IN VARIOUS STAGES OF INSOLVENCY AND OF THE 7 THAT HAVE BEEN RESOLVED

MADHYA PRADESH

Avantha Power
Seoni Jhabua
₹ 3,488 cr

Essar Power
Mahan
₹ 5,951 cr

Jaypee Power Ventures
NIgrie
₹ 6,211 cr

Jaypee Power Ventures
Bina
₹ 2,254 cr

PUNJAB

GVK Industries
(RESOLVED)
Goindwal Saheb
₹ 3,523 cr

MAHARASHTRA

Lanco Vidarbha Thermal Power
Mandva
₹ 4,762 cr

GMR Energy
EMCO Warora
₹ 2,905cr

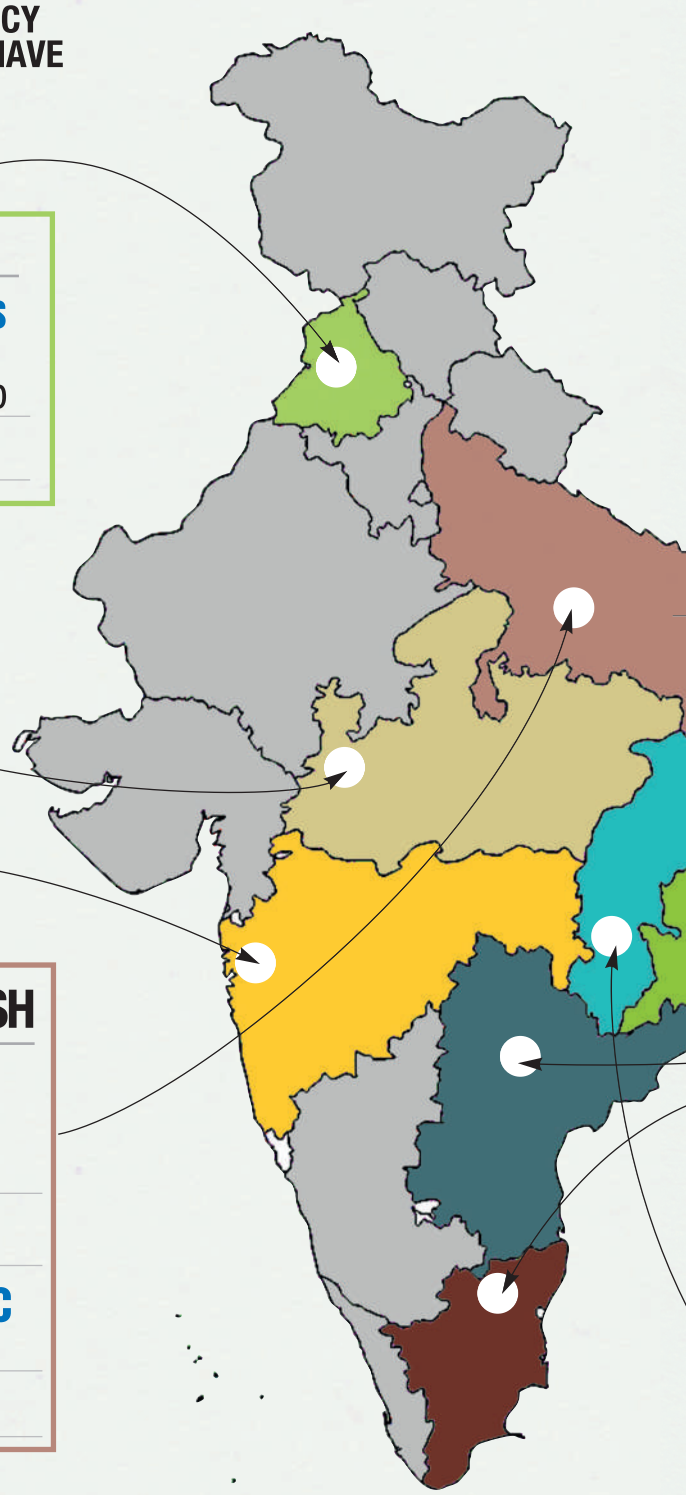
Rattan India Nasik Power
Nasik
₹ 7,107 cr

Adani Power Maharashtra
(RESOLVED)
Tirora
₹ 11,765cr

UTTAR PRADESH

Jaypee Power Ventures
Bara
₹ 11,494 cr

Lanco Anpara-C
Anpara
₹ 3,071 cr



Outstanding loans as of March 2018; projects may include one or more units.
Source : Ministry of Finance, Ministry of Power

JHARKHAND

Essar Power (Jharkhand)
Tori
₹ 3,112 cr

Adhunik Power and Natural Resources
(RESOLVED)
Mahadev Prasad
₹ 2,474 cr

BIHAR

Kanti Bijlee Utpadan Nigam
(RESOLVED)
Muzzarffarpur
₹ 2,506 cr

WEST BENGAL

Damodar Valley Corporation
(RESOLVED)
Raghunathpur
₹ 2,318 cr

ODISHA

Jindal India Thermal Power
Derang
₹ 5,381 cr

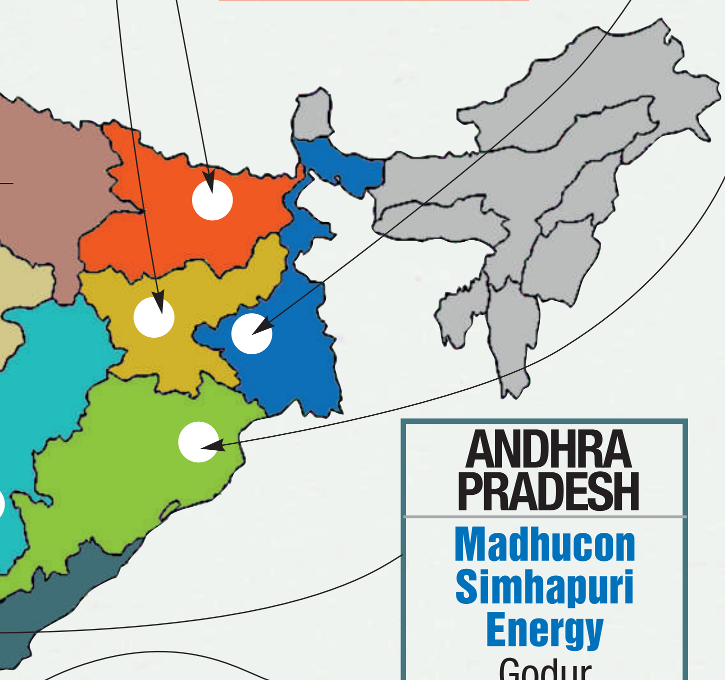
Monnet Power Company
Malibrahmani
₹ 5,300 cr

Lanco Babandh Power
Dhenkanal district
₹ 6,976 cr

Ind Bharath Energy (Utkal)
Utkal
₹ 3,046 cr

KVK Nilachal Power
Nilachal
₹ 1,072 cr

GMR Kamalanga Energy
(RESOLVED)
Kamalganga
₹ 4,100 cr



ANDHRA PRADESH

Madhucon Simhapuri Energy
Godur
₹ 2,206 cr

East Coast Energy
Bhavanpadu
₹ 2,834 cr

TAMIL NADU

Coastal Energen
Mutiara
₹ 6,132 cr

CHHATISGARH

Visa Power
Deveri
₹ 1,481cr

KSK Mahanadi Power Company
Akaltara
₹ 17,194 cr

GMR Chhattisgarh Energy
Raikheda
₹ 8,174 cr

Vandana Vidyut
Salora
₹ 1,488 cr

Adani Power
Korba West
₹ 3,099 cr

RKM Powergen
Uchpinda
₹ 9,145cr

DB Power
(RESOLVED)
Baradhara
₹ 6,721 cr

Lanco Amarkantak Power
Pathadi
₹ 8,782 cr

SKS Power Generation
Binjkote
₹ 4,801cr

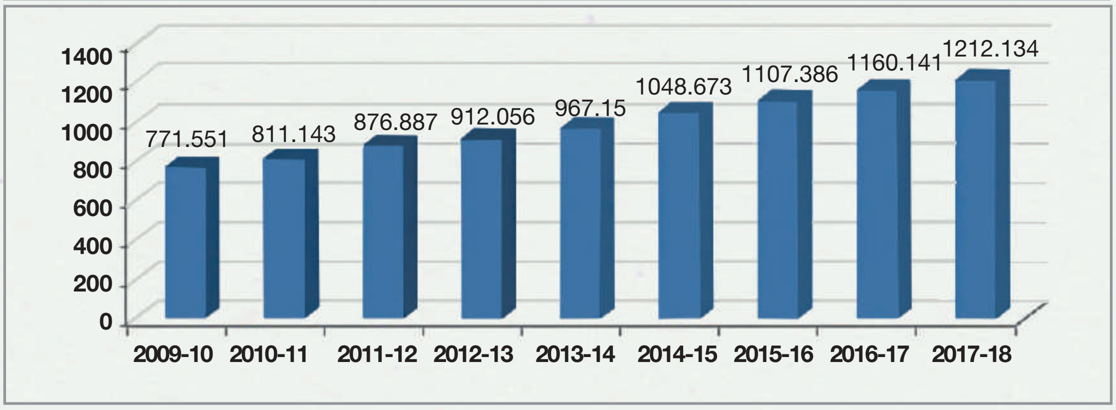
Athena Chhattisgarh Power
Singhitaral
₹ 5,256 cr

mechanism, changes required in the provisioning norms/ Insolvency and Bankruptcy Code (IBC), Asset Restructuring Company, Regulations and any other measures proposed for revival of stressed assets so as to avoid such investments becoming NPA, as stated in the Economic Survey 2016-17 released in August last year.
To note, non-performing assets in power sector account for around 5.9 per cent of banks total outstanding advances of ₹4.73 trillion.

The major concern here is that bids made for ₹1 to 2 crore per megawatt, which is just about a fifth of the ₹5 crore per MW needed for setting up anew. This not accepted, the government came out clear, stating that it did not include assets in place and would throw up the units at very low prices.

This is a rather sad situation for the power industry in India. There was once a situation

GENERATION CONVENTIONAL SOURCE

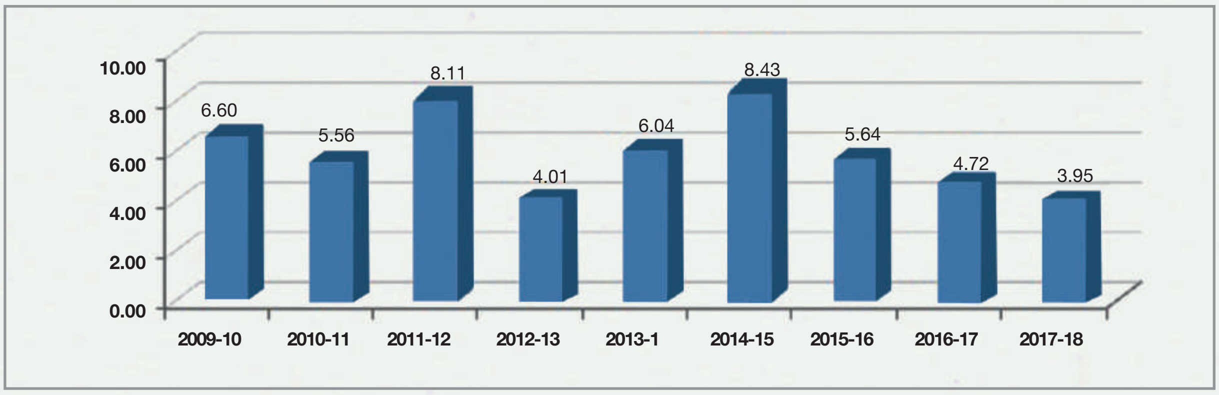


***Source** : Central Electricity Authority (CEA)*

when a power-deficit nation turned a net exporter. Electricity shortage reduced from four per cent on demand in 2014 to less than one in 2017. India managed to increase its total power capacity by a third in just years by 31 per cent from 243 GW in March 2014 to 320 GW in March 2017.

It is estimated that 34 thermal power projects, representing 40 GW of capacity have gone sour putting a question on the fate of ₹1.74 lakh crore in bank loans. Major lenders are now facing a probable situation of taking as much as 80 per cent haircut in massive loans extended to power plants. The situation has worsened with India's new bankruptcy rules and a recent central bank directive which has led the companies involved run out of time for negotiation and course correction before they face distress selling of assets.

GROWTH INCONVENTIONAL



***Source** : Central Electricity Authority (CEA)*

During the 12th Five-Year Plan, private firms added 54,279 MW of capacity in the total 99,209 MW capacity added. This was more than the projection, about 116 per cent of the target given.

State government-controlled utilities added 24,477 MW, whereas the central PSUs generated an additional capacity of 20,452 MW. The massive contribution by the private sector helped achieve the good news described earlier. In 2017, India became a net power exporter, selling 5,798 million units to Nepal, Bangladesh and Myanmar. However, it may be noted that total installed capacity does not mean all of it is produced. Production depends on demand, which is linked to consumer's access to electricity and their ability to pay.

The private sector was always allowed to produce power. With the enactment of the Electricity Act, 2003, private companies added more megawatts in capacity than all the state-owned utilities that once dominated the sector over years.

The viability of a thermal power plant, therefore, depends on a complex matrix of factors. Seamless availability of coal, power purchase agreements with distribution companies at a favourable rate, demand and the price of non-thermal sources of power. Incidentally many of these companies were affected by the Supreme Court's 2014 cancellation of coal block allocations.

The challenge from renewable sources is another factor. In May 2017, the Solar Energy Corporation of India received a winning bid of ₹2.44 per kilowatt hour (kWh) from ACME Solar Holdings Pvt Ltd. for a 500 MW phase of the 10,000-hectre Bhadla Solar

Park, bordering the Thar desert. Thermal power prices average to ₹3.7 per kWh in India's power exchanges.

For the tariff-sensitive and debt-saddled distribution companies, mostly owned by state-governments, who love nothing more than be able to offer cheaper power to a mass vote bank, it was a cheaper source of power. They were not about to conclude power purchase agreements in a hurry.

During 2017-18, for the first time in India, 11,788 MW were added as renewable capacity of power compared to a combined 5,400 MW from thermal and hydro sectors. Thermal power contributes around 65 per cent to India's energy basket. However, the cumulative effect of these meant that the companies that set up coal-fired thermal power plants were either unable to start production for lack of coal, or were unable to find buyers of their produce.

> Much of the attempts to recover bad loans from industries have been very fragmented with an ineffective law regime governing insolvency and bankruptcy proceedings. Thus a number of policies, laws and regulations have been framed time and again to contain the growing menace of non-performing assets that have made industries sick

Thus comes a situation when there are 34 thermal power projects with 40,130 MW of assets bringing forth a ₹1.74 lakh crore in debt that threatens to go bad. Seven of those stressed projects — Adani Power's Korba Chhattisgarh, Adhunik's Jharkhand plant and GMR's Kamalanga Odisha, to name a few have been resolved, according to finance ministry documents.

For Jaypee Power Ventures three projects worth ₹29,078 crore (two in Madhya Pradesh, Nigrie and Bina and one in Bara in Uttar Pradesh) turned non-productive resulting in a bad debt of ₹19,959 crore. In the case of Lanco, the outstanding debt in four of its stressed power assets in Chhattisgarh, Uttar Pradesh, Maharashtra and Odisha is at a whopping ₹23,591 crore.

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State Bank of India, Power Finance Corporation, Punjab National Bank, ICICI Bank, Axis Bank and IDBI Bank were the financial institutions that took the major hit of this power mess of 34 stressed assets.

The situation may have worsened had it not been the timely intervention of the Supreme Court, stopping a move by the apex bank which had ordered that a bank should draft resolution plans within 180 days in the case of stressed assets where it has exposure of more than ₹2,000 crore. This meant that all 34 cases would have gone up for liquidation in the bankruptcy courts run by the National Company Law Tribunal (NCLT).

These apart, issues related to coal supply and power purchase agreements, the consensus among stakeholders' woes, aggressive bidding by private players, the promoters' inability to infuse equity, and contractual or tariff-related disputes have added to the sector's difficult times.

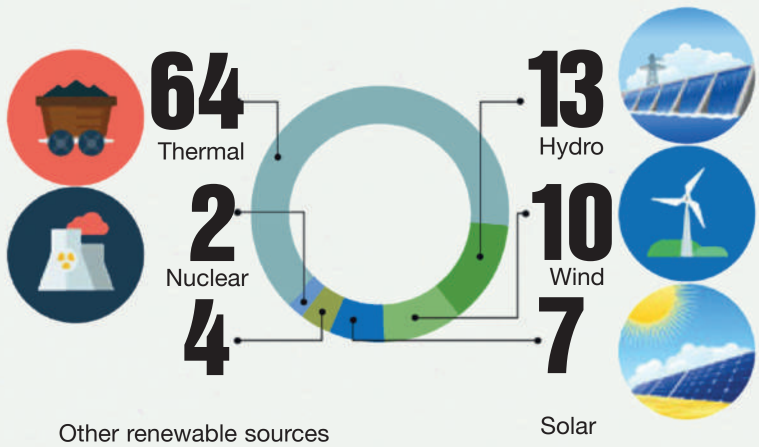
Bankers are now, some might say belatedly, wary of the sector. As many as in 16 out of 21 govt-owned banks, the exposure to the power sector lending has dropped between 2016 and 2018, with the exception of a handful of banks.

The reduction in exposure could also be because of no new addition to loans to the sector, or, for writing off bad loans, or both.

It is also argued that that more government interventions may be required to make the auction of power sector assets a success.

The mutual settlement route between the stressed companies and lenders could also be a plausible solution for the messy situation the industry has landed in.

Thermal is two-thirds of India's installed power capacity* (%)



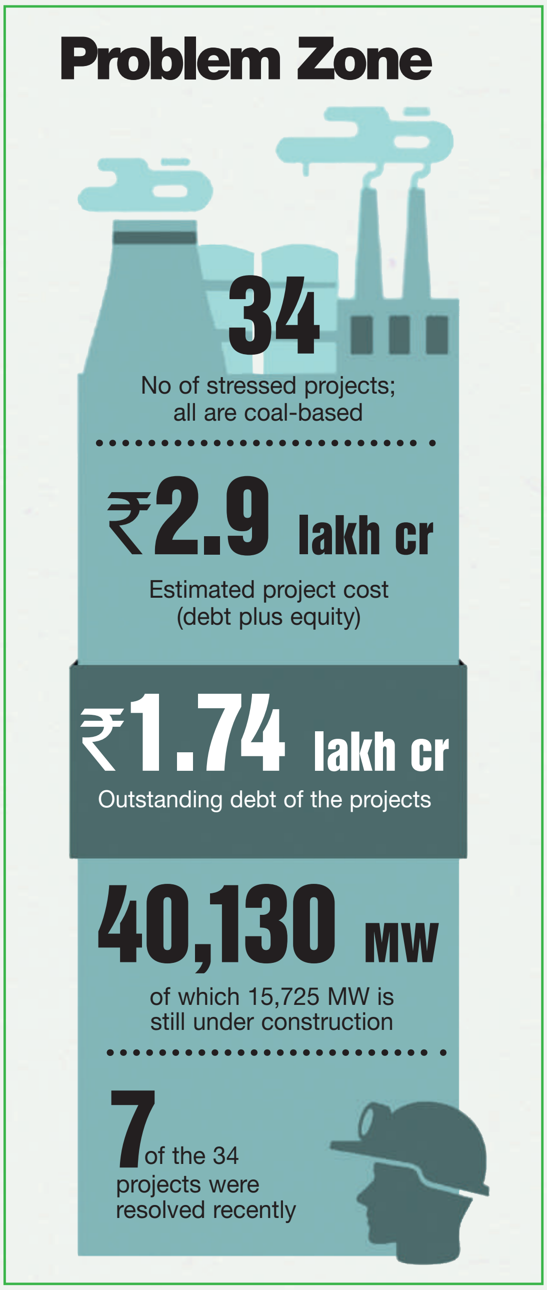
*as of August 2018' figures for renewable energy are as of June 2018
Source : *Central Electricity Authority (CEA)*

As demand for electricity is only expected to grow and with no new thermal and hydro projects coming up, projects under duress now are expected to become viable in the near future.

However, operation and maintenance will remain a challenge, a common malady for all ailing industry in India. The tapering supply of fuel will also be a key issue that needs to be resolved in the immediate future. It will be good if renewable, whose demand is rising steadily, can manage to reduce the dependency on thermal. So there will be a buyers' interest in thermal projects that can be revived to meet additional demand of future.

The government on its part plans to set measures to boost electricity demand in the country. It has an ambitious plan to connect all homes across India by 2019 at whopping investment of ₹1.75 crore as a priority project. There are also plans of setting up a pan-India power distribution company, given that the segment will be key to the long-term fortunes of the power sector.

The government is also likely to launch a fresh round of auction of power purchase contracts while also allowing escalation and fixed charges to power companies in a bid



to alleviate stress in the sector. Ahead of polls and setting in of summer demand, the auctions will help stranded and underutilised power plants sign agreements with state distribution utilities for three years. There are 14,000 MW stranded and underutilised power units, of which close to 8,000 MW have coal supplies but no power purchase agreements. As per official data amid stress in the power sector, woes of electricity generating firms have increased further as their outstanding dues on state distribution companies rose to ₹39,498 crore in October 2018, up 24.7 per cent from a year-ago levels.

The government will soon also approve the power tariff policy which would provide for a penalty for unscheduled power cuts by distribution companies from April this year.

Distribution companies have so far been the weakest link in the electricity value chain. They are plagued by poor payment records — particularly in state-owned electricity distribution companies. This has not only adversely affected power generation companies, but has also contributed to a build up of stress in the banking sector.

However, the problems faced by financial institutions and lenders to the industry remain unresolved as of now. Questions are raised whether these assets will live enough to the see brighter days when demand picks up, or would it be wiser to take a haircut and move out of the bad assets. Time and policies will decide as power remains a sensitive product that need to come cheap and in good quality.

A match has to be found in meeting demand with high quality power (a constant complaint and woe of the Indian industry as a whole), that is cost effective to suite the palate of the mass consumer and industry as a whole.

Stressed Asset - A Way Forward Through Distribution Reform And Fuel Security Through SPV

Rabindra Nath Sen

Ex-Chairperson, West Bengal Electricity Regulatory Commission

To address the abnormal increase of Non-Preforming Assets (NPA) in the financial sector RBI substituted the previous guidelines with a harmonised and simplified generic framework. For resolution of stressed assets enacted Insolvency & Bankruptcy Code (IBC) 2016. This came into effect from December 2016. Subsequently RBI issued circular no. DBR No.BP.BC.101/21.04.048/2017-18 on 12.2.2018 which had withdrawn schemes like flexible structuring (RBI Circular dated 15/07/2014, 15/12/2014 and 05/05/2017) and the Refinancing Scheme for existing debt (RBI Circular dated 07/08/2014) without any restructuring classification.

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Details of Stressed Assets

Project Name	Capacity (MW)	Completed/ Under Construction	Completed but not Operational	Commercially commissioned and Operational	FSA Tied Up	PPA Tied Up	Estimated Project Cost (Equity & Debt)	Stage of Insolvency
Adani Power Maharashtra Limited	3300	Completed	NA	Yes	3085	3085	19,788.00	Resolved
Adhunik Power & Natural Resources Ltd.	540	Completed	NA	Yes	0	322	3,377.00	Resolved Sold to ARC
Athena Chhattisgarh Power Ltd	1200	Under Construction	NA	NA	600	220	11,522.00	Admitted to NCLT
Avantha Power (Jhabua)	600	Completed	NA	Yes	600	245	4,806.00	

Project Name	Capacity (MW)	Completed/ Under Construction	Completed but not Operational	Commercially commissioned and Operational	FSA Tied Up	PPA Tied Up	Estimated Project Cost (Equity & Debt)	Stage of Insolvency
Avantha Power (Korba)	600	Completed	NA	Yes	600	0	4,929.00	
Coastal Energen Pvt. Limited	1200	Completed	NA	Yes	NA	600	7,870.00	
Damodar Valley Corporation Raghunathpur	1200	Completed	NA	Yes	550	550	7,957.00	Resolved
DB Power Limited	1200	Completed	NA	Yes	600	518	8,965.00	Resolved
East Coast Energy Pvt. Ltd.	1320	Under Construction	NA	NA	0	100	9,975.00	Admitted to NCLT
Essar Power Jharkhand Ltd.	1200	Under Construction	NA	NA	0	1050	10,441.00	
Essar Power Mahaan Ltd.	1200	Completed	Unit 2 to be commissioned	Unit 1 is commissioned	0	275	7,173.00	
GMR Chhattisgarh Energy Ltd.	1370	Completed	NA	Yes	0	69	11,643.00	
GMR Kamalanga Energy Ltd.	1050	Completed	NA	Yes	500	887	6,519.00	Resolved
GMR Warora Energy Ltd.	600	Completed	NA	Yes	600	600	4,250.00	
GVK Industries Ltd. (Goindwal Sahib)	540	Completed	NA	Yes	0	540	4,773.00	Resolved but under Stress
Ind Bharath (utkal) Ltd.	700	Unit 1 is operational; Unit 2 is under construction	NA	Unit 1 is commissioned	NA	500	4,797.00	

Project Name	Capacity (MW)	Completed/ Under Construction	Completed but not Operational	Commercially commissioned and Operational	FSA Tied Up	PPA Tied Up	Estimated Project Cost (Equity & Debt)	Stage of Insolvency
Jaypee Power Ventures Pvt. Ltd. (Bina)	540	Completed	NA	Yes	500	350	3,575.00	
Jaypee Power Ventures Pvt. Ltd. (Nigrie)	1320	Completed	NA	Yes	500	495	11,700.00	
Jindal India Thermal Power Ltd.	1200	Completed	NA	Yes	600	544	7,061.00	
Kanti Bijlee Utpadan Nigam Ltd.	390	Completed	NA	Yes	390	390	4,778.00	Resolved
KSK Mahanadi Power Co. Ltd.	3600	Phase 1 Completed; Phase 2 under Construction	NA	Phase 1 is operational	0	2270	27,080.00	
KVK Nilachal Power Ltd.	350	Under Construction	NA	NA	350	88	2,992.00	Referred to NCLT
Lanco Amarkantak Power Ltd.	1920	Phase 1 Completed; Phase 2 under Construction	NA	Phase 1 (600 MW) is operational	1920	672	12,865.00	
Lanco Anpara Power Ltd.	1200	Completed	NA	Yes	1200	1100	4,845.00	
Lanco Babandh Power Ltd.	1320	Under Construction	NA	NA	660	545	13,400.00	Referred to NCLT
Lanco Vidarbha Thermal Power Ltd.	1320	Under Construction	NA	NA	0	0	10,443.00	
Monnet Power Co. Ltd.	1050	Under Construction	NA	NA	0	476	9,500.00	Admitted to NCLT
Prayagraj Power Generation Company Ltd. (jaypee)	1980	Completed	NA	Yes	1980	1782	15,537.00	

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Project Name	Capacity (MW)	Completed/ Under Construction	Completed but not Operational	Commercially commissioned and Operational	FSA Tied Up	PPA Tied Up	Estimated Project Cost (Equity & Debt)	Stage of Insolvency
Rattan India Power Ltd. (Nasik)	1350	Completed	NA	Yes	1080	650	9,818.00	
RKM Powergen Private Ltd.	1440	Unit 1,2,3 Operational; Unit 4 Under Construction	NA	Unit 1,2,3 Operational	900	350	12,608.00	
Simhapuri Energy Ltd. (Phase 1&2)	600	Completed	NA	Yes	NA	400	3,510.00	
SKS Power Generation Chattisgarh Ltd.	600	Completed	NA	Yes	300	30	6,180.00	
Vandana Vidhyut Ltd.	270	Completed	Yes	NA	0	14	1,949.00	Admitted to NCLT
Visa Power Ltd.	600	Under Construction	NA	NA	NA	600	4,500.00	Admitted to NCLT
	38870				**17515**	**20317**	**2,91,126**	

Let us try to understand the reason for creation of stressed assets, During the last five year plans the installed capacity had been added by 27,283 MW, 56,816 MW & 1,03,489 MW respectively in 10^{th},11^{th} and 12^{th} five-year plan resulting CAGR in capacity addition of 12.67 per cent. Against the projected demand growth of 8.0 per cent whereas actual demand growth remained at 5.36 per cent despite massive Rural electrification and Made in India drive.

The Electricity Act 2003 created a conducive environment to promote private sector participation and competition in the sector by providing a level playing field. This has led to significant investment in generation, transmission and distribution areas. The share of private sector in overall installed capacity has grown from 13 per cent in March, 2007 to 44 per cent in March, 2017. During the last ten years, the public sector (both Central and State combined) contributed 73,402 MW while private sector alone contributed 77,891 MW capacity addition.

Prior to the demand crunch, the power sector faced sudden failure of coal sector which resulted in refusal of CIL in honouring the linkage allotted while approving the project for financial closure. From April 2009, CIL stopped signing FSA (Fuel Supply Agreement) thus bringing uncertainty on fuel availability and commercial operation of the units even after they were ready to generate at its full capacity. This forced GOI to allow import of coal at a very high price to make units operate & meet the growing energy demand. The higher fuel cost pushed the already financially stressed Distribution licences for heavy market borrowing to sustain the power purchase during election years. This resulted in steady increase in outstanding loan amount and GOI to impose restriction on PSU banks to stop lending to Distribution licences who in turn reduced the power purchase thus resulting in slow down in entering to new PPA with the IPPs. With the reduction in power purchase and continuous capacity addition both by IPPs and state-owned power generators the Power Exchange price started falling which driven away the Distribution licensees in signing new PPA and terminating already signed PPAs which followed by refusal of CIL for allocating coal linkages/ signing of FSA. This ultimately forced most of the upcoming IPPs in this present situation which further aggravated with the refusal of the financial institutes in continuing funding to meet the immediate cash requirement both for completion of balance work of the project and operating cost due to delay in payment/ non-payment by the state Distribution licensees.

Unlike other industrial product power cannot be exported to such a large volume in the absence of required infrastructure like transmission lines of required capacity, so for revival we will be needing both market and adequate supply of coal at affordable price. Even if the lenders can sell the stressed assets at a discount and recover around 50 per cent amount after taking haircut, the new owner will be only interested after the above two conditions are met otherwise the project may again land up at NCLT as it happened in case of Minakshi Power. In such case only State-owned companies with government support for above two issues may be interested thus limiting the possibility of getting enough buyer at appropriate price and revival of the project to address the country's growing energy need. Going to NCLT may help the financial institute to clean their balance sheet after taking massive haircut without the prospect of performing in the hands of new owners.

As on date the CAGR of power demand is about 5.31 per cent whereas the capacity addition both at conventional and non-conventional together is 7.34 per cent with the aim of adding 175 GW of RE power, by the year 2022. Thus, it may lead to more surplus due to generation surpassing the increase in power consumption. The capacity utilisation of the running units may further deteriorate from the present level of 58 per cent thus fresh look is needed to increase the consumption. With the adoption of Electrical Vehicle (EV) there likely to have substantial increase in demand of power in addition to improvement of climatic condition and reduction of oil import thus saving over stressed foreign exchange. "Out of the 34 stressed projects, around 35 per cent are under construction. Project progress achieved in these under construction projects is ranging from 45 per cent to 85 per cent with residual project completion time lines between 9 months to 24 months from the date of Re-financing and Re-mobilisation. Since 2012, construction work at these projects are stalled due to various reasons beyond the control of developer. Disbursement made by banks during the stalled period mostly served the IDC component and a very small percentage of the disbursed amount, which in many projects would be in single digit, was allowed by banks to be utilised towards project construction. As a result, most of the projects have an IDC component in excess of 50 per cent of the total project cost. These stalled under construction projects currently are servicing debt at a Rate of Interest between 15 per cent to 17 per cent including penal charges of 2 per cent. The high-tech thermal power plant equipment stored at various ports and project sites without preservation because of zero disbursements by banks post end of 2016, also they are without basic insurance coverage like fire, burglary etc., due to paucity of funds."

The above issues get endorsed by the 37th Parliamentary Committee on Energy and presented its report on "Stressed/ Non-Performing Assets in Electricity Sector" in the 16th Lok Sabha. Subsequently Hon'ble Standing Committee on Energy (2017-18) submitted its 40th report on 07/08/2018 where in some of their submission they have stressed the followings, The Committee note that about 66 GW of conventional energy is under various degrees of financial stress which include 54805 MW of Coal based Power (44 assets), 6831 MW of Gas based Power (9 assets) and 4571 MW of Hydro power (13 assets). In addition, certain assets from Power Sector have already been referred for CIRP (Chartered Insolvency Re-structing Professional) under IBC.

The Committee observe that the Electricity Sector is in a transitional phase and is moving from a low demand-low supply situation to a moderately high demand context. The Committee feel that the RBI framework is ignorant as well as unmindful of prevailing reality of the Electricity sector and that is why it addresses only the financial issues ignoring the whole range of vital issues of the Electricity sector. The Committee are of the view that two major important contexts should be taken into consideration - one is the need for a national energy security in the context of managing the transition in the Electricity Sector and the other is the need to preserve, protect and conserve these stressed assets as these are national assets at the end of the day. There are doubts that all the stressed power projects would ultimately be referred to NCLT whereinafter they will be auctioned at throw away prices. The Committee are not in favour of such procedure which is more for dissolution rather than resolution of stressed assets.

For a Power Project in Chhattisgarh, against the debt of ₹8300 crores, an offer of only ₹ 2500 crores have been made i.e. a hair-cut of about 70 per cent has to be incurred and a Power Plant in Jharkhand got a bid of ₹35 lakh per MW. One of the stressed plants have been restructured but it is still in stress because the promoters cannot solve the systemic issues. The Committee are of the opinion that forced sale under the NCLT will end up causing a big sacrifice of public money without any benefit to the Economy or to the Electricity Sector which would be baffling.
It was stated before the Committee that the Lender's actions under IBC in order to resolve the stressed assets in the Electricity Sector are inflicted with certain limitations such as:

i) Sub-Optimal Bid Outcome

- 5 to 6 change in Management bids have been conducted by lenders.
- Bids of ₹1.02 Crore per MW to ₹2.5 Crore per MW.
- 46 per cent to 19 per cent recovery of principal.

ii) Small Buyer Universe

- Asset specific risks are not mitigated currently.
- Significant undisclosed liabilities risk buyer returns.

iii) Weak Commercial Framework

- Many commissioned assets without adequate PPA / FSA.
- Difficult to determine Market value for such assets.

The Committee has clearly spelt out that the net revenues generated by the suggested measures shall be used entirely for servicing debt in the 1st place.
Aggrieved by the RBI circular dated 12.02.2018 IPPAI filed Writ petition at Allahabad High court after hearing them Hon'ble Allahabad High court vide order dated 31.05.2018 stayed the implementation of RBI circular dated 12.02.2018 in case the they are not the wilful defaulter and directed the Secretory Finance, GOI for conducting meeting with the President of petitioner. now the matter with Hon’ble Supreme Court of India

Subsequently Government of India has formed a High-Level Empowered Committee (HLEC) to address the issues of stressed thermal power projects. HLEC has submitted their recommendations on 20th November 2018 stating the following:

- Allocation and supply of coal for short term PPAs,
- Coal supply in case of termination of PPAs due to default in payment by DISCOMs,
- Procurement of bulk power by a nodal agency against pre-declared linkage,
- PSUs to work as aggregator of power,
- Increase in quantity of coal for special forward e-auction for power sector,
- Linkage provisioning at noticed prices without bidding,
- Annual Contract Quantity (ACQ) for coal to be determined based on efficiency,
- Retirement of old and inefficient plants,
- Monitoring of payments by regulator,
- Payment Security Mechanism to IPPs,

Issuing advisory to DISCOMs, CIL, PGCIL, MoEF for not cancelling PPA, FSA and transmission connectivity, environment clearance/ forest clearance respectively, even if the project is referred to National Company Law Tribunal (NCLT) etc.

Coal Requirement Scenario based on Generation Growth

Sl. No.	Description		2012-13 Actual	2013-14 Actual	2014-15 Actual	2015-16 Actual	2016-17 Actual	2017-18 Est	2018-19 Est	2019-20 Est	2020-21 Est	2021-22 Est
1	Coal Requirement											
1.1	Coal based generation	BU	659.2	713.8	800.3	862.0	910.1	959	1013	1071	1132	1196
	Growth rate over previous year		12.7	8.3	12.1	7.7	5.6	5.4	5.6	5.7	5.7	5.7
1.2	Specific Coal Consumption	Kg/kWh	0.69	0.69	0.66	0.65	0.65	0.65	0.65	0.65	0.65	0.65
1.3	Coal Requirement (incl. Transit loss)	MT	459	497	533	566	598	630	665	703	743	785
1.4	Imports by plants designed on imported coal	MT	31.3	42.2	42.7	43.5	46.3	50	50	50	50	50
2	Domestic coal Requirement (1.3-1.4)	MT	428	455	491	522	551	580	615	653	693	735
3	Domestic Coal availability/ despatch											
3.1	From CIL	MT	325.4	353.8	385.7	409.1	420.1	450.0	512.6	537.5	566.5	594.8
3.2	From SCCL	MT	38.2	34.3	39.2	47.3	51.5	52.0	53.0	54.0	54.0	54.0
3.3	From Captive Mine	MT	22.7	22.6	31.9	23.9	27.5	34.0	37.0	49.0	60.0	74.0
3.4	From e-auction	MT	5.2	7.4	6.3	13.5	29.1	28.0	12.0	12.0	12.0	12.0
3.5	Total domestic coal availability (3.1 + 3.2 + 3.3 + 3.4)	MT	411.5	418.1	463.1	493.8	528.3	584	615	653	693	735
3.6	Growth in Domestic Coal Availability	%		1.6	10.8	6.6	7.0	10.6	5.2	6.2	6.1	6.1
4	Shortfall (-) / surplus (+) in domestic availability (1.5-2)	MT	-17	-37	-28	-29	-23	4	0	0	0	0
5	Actual Import by power plants for blending	MT	31.9	37.8	48.5	37.1	19.8	20	0	0	0	0
6	Total Import (1.4+5)	MT	63	80	91	80.6	66	70	50	50	50	50

It is clear from the above table that there an urgent need for augmentation of coal supply from other sources in addition to CIL. Details of coal production and power generation.

By FY 2022, we will need additional around 120 MT of coal for meeting the growing demand in power sector except cocking coal for which we may have to continue our dependence on import. This makes us to look for additional coal production of 60MT from the sources other than CIL and Singareni Collieries Company Limited (SCCL). After cancellation of 204 numbers of coal blocks not much of improvement has been noticed in the allotment of coal blocks and production from the allotted blocks. Now there is a need for fresh look, we may consider for allotment of cancelled blocks and some additional coal blocks to the respective state where the coal block is located to ensure speedy acquisition of land and all other clearances related to states in a time bound manner with the condition of imposing penalty leading to cancellation in case of delay. To ensure latest scientific environment friendly mining through satellite imaging respective state may enter in to joint venture or consult internationally reputed coal miners for highest extraction of coal from its reserve. Similarly, both MOEF and MOC may be directed for speedy disposal of clearances and required approvals in a specific time frame. The coal produced by the state coal companies may be consumed by state owned organisations and they may release their linkages for supplying to IPPs and others by CIL. This will ensure adequate quantity and quality domestic coal at reasonable price to keep cost of coal generation at affordable level.

The major corner stone in the power sector is the failure of the majority state owned distribution licensee in operating them professionally both in operation and in financial management. In order to ensure timely payment by the distribution licensee it is essential to improve their financial health. Under UDAY scheme GOI has made provision of sharing major loan burden of distribution licensee by respective state government but to sustain their financial health on continuous basis it is essential to improve the billing and collection efficiency along with reduction of AT&C loss at international level. This demand switching over to prepaid smart meters to ensure 100 per cent metering and collection in advance along with HVDS (High Voltage Distribution System) with AB (Arial Bunch) cable this will prevent theft and will minimise the technical losses at international level thus drainage of revenue loss can be reduced around 20 per cent. The payback period will be around 5-10 years. This will ensure 100 per cent availability of cash thus timely payment to all debtors and reasonable profit without any government support. This will also ensure 24X7 quality power even at the remotest corner of the country which will automatically improve the rural and small-town quality of life and economy thus minimising the migration of people to city. By ensuring quality power including rural India and migrating to EV (Electric Vehicle) from present day petrol and diesel vehicle will ignite per capita power demand which is presently 1/3rd of world average to a reasonable figure.

The problem of stressed coal base thermal assets has created huge challenge for the financial sector and country, but it also given us the opportunity for a fresh look both at Coal and Railways including the state-owned distribution sector. We may have to look for major distribution reform as within this country privately owned distribution licensee are both operating efficiently and making enough profit.

Due to non-availability of Fuel, PPA and fund all the stressed assets are stuck up at various stages of construction and operation, if corrective action is not taken immediately most of the plant and equipment may get damaged beyond repair thus hitting the power sector very badly. To ensure best recovery of the loans from the developers we must bring most of the stressed assets in to commercial operation with adequate fuel and payment security otherwise financial institutes will settle with massive haircut and country may lose majority of these assets resulting set back in private investment for the growth of the country.

To protect the interest and control of the financer we may decide in formation of SPV (Special Purpose Vehicle) by the financer with well reputed generator like NTPC and others. The SPV is to be provided adequate support by providing fuel and payment security along with timely clearances by respective government department without delay. The strong management commitment along with these supports will bring these SPV in performing level thus make win-win situation for all and fuelling growth of the country.

Rabindra Nath Sen

Recently retired as Chairperson, West Bengal Electricity Regulatory Commission is having vast experience in power sector. Earlier he had served as Chairman and CEO of Damodar Valley Corporation, CEO of NTPC-SAIL (Joint Venture), Managing Director, NTPC Alstom, Executive Director, NTPC (Operational Services), Head of Project, NTPC Badarpur, Faridabad and Auraiya. He has rich experience in coal-based plant, gas-based plant and hydro power station including transmission and distribution etc. As a General Manager, Badarpur, he has turned around the Badarpur Plant which subsequently NTPC took the ownership from Government of India during his tenure. During his tenure as Executive Director of NTPC Operational services, NTPC achieved the highest annual Plant Load Factor (PLF) of 92.24 per cent by surpassing earlier PLF 89.9 per cent. During his tenure DVC saw a major revival by completing all the on-going projects including by major improvement in the operating plant performance and Transmission and Distribution System. Superannuate As a Regulator he has initiated power sector reform

We acknowledge his contribution and are thankful for the same.

Credit Squeeze in Infrastructure

With banks having become cautious in committing fresh investments, the infrastructure sector is in a spot with cost over runs and bad debts

The growth in bank credit for infrastructure projects has been depleting for the past few years as financial institutions and PSU banks, major lenders to infrastructure projects, have become cautious over the growing non-performing assets in the sector.

Banks are now averse to the sector due to the deterioration in credit quality of projects in the sector. Lenders at present, mainly banks, are facing huge losses from having lent to the infrastructure sector.

A slowdown in India's economy, lack of long-term alternative financing options, regulatory delays in clearances, persistent policy paralysis, build-up of excess capacity, delays due to environmental concerns and deficiencies in the credit appraisal of the banks are some of the key factors that hampered the smooth implementation of large infrastructure projects.

Such is the situation that it has become difficult in getting adequate bank guarantees that are often required for engineering, procurement and construction (EPC) projects.

However, there is a development in resolving stressed assets in the EPC space. Indian Bank has evolved a model for resolution of stressed assets in the infrastructure space by seeking to bundle the parent company and the special purpose entity or vehicle it has floated for each project into a single entity to pursue a holistic resolution.

Typically, an EPC is usually a holding company and generally doesn't have any assets. It is the special purpose vehicle in which the assets are housed. In the case of Era Infra which has road assets — all 34 banks who have exposure came together to make one entity (all SPVs and the parent company are merged). So, lenders here have a better way of settlement. The claim on NHAI is to the extent of ₹20,000 crore.

There are complex factors that govern the credit quality of various infrastructure projects. Each is unique and never identical in nature. Let us examine a few.
Infrastructure projects are often complex and involve a large number of parties. Infrastructure often comprises natural monopolies such as highways or water supply, and hence governments want to retain the ultimate control to prevent an abuse of monopoly power. Thus, there is a requirement of a complex legal arrangements to ensure proper distribution of payoffs and risk-sharing to align the incentives of all parties involved.

Infrastructure projects are long term, and therefore, are subject to various risks including those due to changes in policies, delays in clearances, etc. Every event that delays the implementation of a project leads to cost and time overruns that in turn have a bearing on the techno-economic viability of the project or would necessitate revision in the price of the ultimate service. Very often the infrastructure products are created to serve public utilities through good and services. This builds a limitation on ability to determine their sell off prices.
Where debt financing is dominated by a banking system, the fundamental problem that arises is critical nature of the asset-liability mismatch. In India, the dominance of public sector banks partly offset this risk because the perceived assurance of government backing provides the requisite flow of deposits.

In India the share of non-performing assets in infrastructure has increased from 16.7 per cent in March 2017 to 22.6 per cent as on March 2018. The non-performing asset stood at around ₹10.3-lakh crore, a little above 11 per cent of total advances as on March 31, 2018.

The gross NPA of the infrastructure sector is about eight per cent of the total advances to the sector. It is estimated to be nearly 13 per cent of the NPAs of the banking sector. Total stressed assets including restructured standard assets of infrastructure sector was approximately 17 per cent of the total banking sector exposure to the sector and about 21 per cent of the total stressed assets.

The situation has seen hopes of recovery to an extent with the implementation of the Indian Bankruptcy Code. It is a fact that lenders have now the option of recovering part of the debts through the recovery process. Bond market, infrastructure debt funds and alternative investment funds have emerged as options for some of the infrastructure players.

Promoters have the option to dilute promoter's equity and get equity funding from a private equity firm or external investors. Some banks are still giving loans, however NBFCs are being seen as a huge source of funding for infrastructure projects.

At a time when Nation-building needs to be done by the government in the immediate future, the slowdown causes a major concern in providing quality services for mass consumers.

Infrastructure sector will be a key driver for the Indian economy. Given the high priority that the government attaches to infrastructure sector, there lies enormous potential for financing the sector. As per an estimate, India needs ₹31 trillion is to be spent on infrastructure development over the next few years, with 70 per cent of funds needed for power, roads and urban infrastructure segments. It is essential that the stakeholders take the right steps to participate in this move and also make a decent return from this opportunity.

Coal Shortage And Stressed Power Assets-Causes And Remedies

Partha S Bhattacharyya

Former Chairman, Coal India Ltd.
and author of WHEN COAL TURNED GOLD

Addressing a gathering after inaugurating the Mundra LNG Terminal recently, Shri Narendra Modi, Hon'ble Prime Minister of India said "Energy is essential for development. Paucity of energy does not let any nation come out of poverty. If one needs freedom from poverty, wants financial development and a self-sufficient country, energy is necessary." Coal continues to be the dominant source of energy in the country. In recent times endemic shortage of coal has created stressed power plants, unable to service bank debts in time. This has arisen on two counts. Financial distress of discoms has restricted their ability to buy power from gencos leading to the PLF dropping significantly. This directly impacts the ability of the gencos to service bank loans. In addition there are non-operational power plants unable to perform due to insolvency etc. In both cases, efforts to generate more power or commence operations, as the case may be, will require additional supply of substantial quantity of coal. In the current scenario of coal shortage this will become a serious challenge, thwarting development and freedom from poverty. Thus, the statement of Hon'ble PM is of utmost significance and relevance for determining the causes and remedies of the endemic coal shortage situation.

Power generation in India has been suffering on account of coal shortage for more than a decade. An illusory 'coal surplus' situation was seen temporarily in 2016-17. Though attributed to a record 9 per cent growth in coal production by Coal India Ltd (CIL) in 2015-16, it was more due to financial distress of discoms, restricting their ability to buy power from gencos. This led to lowering of average PLF of thermal plants by 2-3 per cent. Since change in PLF by 1 per cent impacts coal demand by 10 Million Tonne Per

Annum (MTPA), a lowering of 2-3 per cent was good enough to create the optical illusion of coal shortage being converted to coal surplus almost overnight. In fact, more than 50 per cent of the record increase in coal production by Coal India Ltd of 42 MT in 2015-16, ended up in coal stocks at pithead and power houses, with consumption rising modestly.

In contrast, Coal India Ltd, in the current fiscal has been growing at its best ever rate of 10 per cent, having accepted a daunting target of 652 MT for FY19. Even then the power houses are running on low stocks, quite a few of them critical. The differentiating factor this year compared to 2016-17 is the movement in average PLF. Instead of lowering, the PLF is rising, though modestly hovering around 60 per cent. As a result, the coal consumption is rising faster than in 2016-17, turning the coal surplus situation to coal shortage once again.

As the financial position of the discoms improve on account of implementation of UDAY as well as with Direct Benefit Transfer (DBT) making deeper inroads in subsidy governance, gencos will be able to generate and sell more power. This will lead to further rise in the average PLF. The power generated by rise in PLF of the existing power plants is least cost, as it entails only the variable cost of coal. Hence, more generation of such power will enable the gencos to a) improve margins and meet debt service payments to banks and, b) pass on a part of the cost savings to discoms through tariff moderation. This will further improve the financial position of discoms. Potentially, this can set in motion a process of rapid increase in PLF with power supply witnessing exponential rise.

At one of the lowest per capita power consumption of around 1100 units per person per year or 3 units per day, India cannot afford to wait any longer in securing the additional power that gencos can deliver through rise in PLF. The highest PLF seen so far is close to 80 per cent in 2007-08. Since then, the new power capacities installed are of improved technology. Besides, some of the high emission, inefficient power plants have been phased out. In other words, the maximum average PLF now attainable could be higher at around 85 per cent. Also, the staggering bank borrowings of gencos can be seamlessly serviced at this level of PLF, avoiding thereby a major crisis in the banking system.

The rise in PLF from the current 60 per cent to 85 per cent will create additional demand of 250 MTPA of coal and generate around 415 BU of power. A further demand of around 150 MTPA can arise if India decides to take effective steps in restricting import of coal to only metallurgical coal for steel plants and thermal coal for coastal power plants designed on imported coal. Then there are projects under construction as well as non-operational power plants that are stressed due to insolvency and other reasons. As the root cause of the stress are addressed by change of ownership through NCLT or other routes and projects in the pipeline get commissioned a further demand of coal of the order of 100 MTPA may arise.

Therefore, creating additional capacity for production of 500 MTPA of coal at the earliest holds the key to economic prosperity and inclusive growth as well as mitigation of the risk of the staggering bank exposure on gencos turning bad. Incidentally, this calculation does not take into account the coal demand from creation of fresh thermal capacities. The underlying reason for this exclusion is the drop in renewable tariff to levels below the cost of power from new thermal power plants which is expected to halt further addition to coal based thermal capacity. It also does not take into consideration fresh coal demand that may arise from the possible use of coal as feedstock for production of oil, gas, ammonia and fertilisers since such demand is unlikely to be substantial in the mid-term.

Relying on Coal India Ltd alone to deliver the additional coal requirement of the projected order, as has been the practice so far, will be infeasible. The experiment with end users mining captive blocks has also not met with any significant success either. Every other major coal producing country such as Australia, South Africa, US, China and Indonesia have multiple coal producers with core competence in mining. This has led to adoption of best in class mining and environmental practices among the coal companies, particularly in Australia, US and South Africa. Environmentally benign, mechanised underground coal mining in China has flourished way beyond conceivable limits while it continues to remain at a nascent stage in India. The consistency of coal quality is yet another parameter that is usually assured in a competitive environment.

The imperative need of raising coal production by 500 MTPA at the earliest to end the endemic coal shortage must be propelled to become a game changer. While Coal India Ltd will expectedly do its best to increase production for which some scope exists, opening up of the sector to commercial mining and getting international companies to compete for large blocks needs urgent focus. Induction of such companies, besides helping to close the demand supply gap sooner than later will help bring in best in class mining and environmental practices, mechanised underground mining and better consistency of coal quality. The resultant competition is expected to move Coal India Ltd. to higher orbit of efficiency. The ultimate objective of creating a matured coal market in the country with consumers having choice of coal sourcing and producers having choice of marketing coal in domestic or export market will bring India closer to energy sufficiency at competitive prices at the least possible time.

The delay in recognising the fact that a country of the size and complexity of India cannot and should not be required to depend on one commercial entity for meeting over 80 per cent of its coal demand has cost us dearly. Way back in early 90s, it was apparent to the Govt that CIL as a commercial entity will not be able to meet coal demand in case the pace of capacity addition in power sector accelerates significantly. This led to the 1993 amendment to Coal Mines Nationalisation Act enabling the Govt to take away around 200 coal blocks with coal resources of 28 billion tonne from CIL and allot the sameto gencos and other end users. Mining of coal by end users has not been a successful model elsewhere. The experience was not different in India either. However, the expected acceleration in the pace of capacity addition in power sector did not materialise till 2007. Since then the pace of capacity addition accelerated exponentially to three times the rate prevailing earlier. Thus, the key reform of opening up the coal sector to commercial mining and inducting formidable players with core competence for supplementing efforts of CIL became imperative in 2007. Not carrying out this reform at that stage and adopting a policy to make CIL responsible for meeting coal demand is the root cause of the endemic coal shortage today. We have lived with this crisis for far too long and will have to live till the reform measure is implemented in letter and spirit and its outcome realised.

Needless to emphasise, the projected growth in coal production will create challenges in the logistics space. Though not a deal breaker, these will have to be holistically reviewed and addressed simultaneously.

Partha S Bhattacharyya

Partha S Bhattacharyya, MSc (Physics) from Jadavpur University joined Coal India Ltd. (CIL) as Management Trainee in 1977, rose to become its Chairman in 2006 and continued till retirement in Feb 2011. He steered CIL through Miniratna in 2007, Navratna in 2008 and finally Maharatna in 2011 - a unique feat in the career of any PSU CMD.
In 2010, Bhattacharyya spearheaded the Initial Public Offer (IPO) of 10% of CIL's equity. It became a landmark event. The IPO was one of the top three in the World in that year and is still the largest in India so far.
In Nov 2003, Bhattacharyya took over the reins of Bharat Coking Coal Ltd (BCCL) - a perennialy loss making CIL Subsidiary - as the CMD. In less than two and a half years, the company reported its maiden profit in 2005-06 and never looked back. The implementation of sale of coal through e-auction was first introduced by Bhattacharyya in BCCL and extended later to all over CIL
In the 90s, Bhattacharyya played a key role in negotiating a large World Bank/JBIC loan for CIL as well as for securing approval of the Govt to a Capital Restructuring Plan that led to transformation of CIL from a loss making PSU to a hugely profit making company.
He has been featured in a document published by Tata Mcgrow Hill in 2011 as one of the Transformation leaders of Corporate India. He was also recognised by Forbes Magazine as a High Achiever of 2010. He is recipient of a number of awards and accolades. Notable among these are CEO of the year 2010 from Indian Chamber of Commerce as well as World HRD Congress, Swami Vivekananda National Award -2011 & SCOPE Special Award of the Jury in 2010.
He has authored WHEN COAL TURNED GOLD, published recently by Penguin with a Foreword from Shri Pranab Mukherjee, Former President of India.
He is currently on the Board of several reputed companies like Haldia Petrochemicals, Usha Martin, Deepak Fertilisers and Petrochemicals, Ramakrishna Forgings, KCT, Mcnally Bharat and Tide water Oil.

We acknowledge his contribution and are thankful for the same.

Slowdown in Construction

Liquidity crunch and project over runs have led projects to become stressed

The construction industry is one of the largest contributors to India's GDP. Being a mega employment generator it has an immense impact in shaping the economy of the country. It is estimated that the value of the real estate and construction market will increase seven folds by 2028.

While all of this seems encouraging, there are innumerable challenges that have been limiting the growth prospects of the construction industry in India. A slowdown in the economy and a fall in its credit quality is a major cause of concern as it sets a rippling effect in the growth performance as a whole.

In recent times, a number of factors have been attributed to the poor performance of the real estate industry. Demonetisation, Real Estate Regulation Act (RERA) and the implementation of GST changed the outlook of real estate business, leading to a build up in inventory. The NBFC crisis has resulted in a liquidity crunch for the Indian real estate sector with sanctioned loans facing difficulties in disbursement. Incidentally, situations such as this throws up opportunities too. Many new real estate funds are eyeing stressed assets and mid-income or affordable housing projects as investment bids. Pick up good projects while prices remain low!

To lend a fillip to the industry, the Ministry of Housing and Urban Affairs approved the construction of another 5,60,695 more affordable houses for the benefit of urban poor under Pradhan Mantri Awas Yojana (Urban). This makes the total number of houses sanctioned under the scheme as 79,04,674. A total of 1,243 projects with a project cost of ₹33,873 crore has been approved.

The residential sector gained prominence with high inflows in past 10 quarters, as investors looked to gain from government incentives in affordable housing. In another development the industry had made a plea to the finance minister on the eve of the budget to consider creating stressed asset fund for incomplete projects. Buyers are hopeful that the government would also take a look at creating stressed asset fund to deal with the issue of incomplete projects and provide an EMI holiday to those whose houses have been facing undue delays. The industry had been booming through the years when lending institutions had disbursed money for projects by the dime and dozen. When the credit squeeze came with most banks withheld further investments to construction companies in India, the damage began to set in. A number of construction projects did not see their completion, a situation when many turned bad.

Why did the money source dry up?

One does not need to delve deep to get an answer. It is because that the major lenders, such as banks, were themselves in distress. The banking sector mess, having brewed unchecked for many years, continued to dominate India's economic performance in 2018. The situation had been put through corrective measures earlier. One of the main efforts was by the government and the apex bank cautioning many banks to take note of their growing bad assets portfolios. Thus, at least 11 public sector banks were put under a prompt corrective action plan of the RBI on account of their weak financial position.

The NCLT process, framed to speed up the resolution of bankrupt companies, has offered some relief to the banks to recover at least part of the bad loans. But the crisis phase is not over for banks yet. About 70 per cent of the banking system continues to be dominated by state-run banks. Among them, except for a few, the financial position of most banks continues to be bad.

The plight of NPA-ridden banks continued to dominate the woes of the Indian economy in 2018. As of December 2017, total 40 listed banks had gross NPA's at ₹8,86,460.30 crore. This grew to ₹9,99,031 crore by the end of September 2018, which is a jump of ₹1,12,571 crore in about a year.

The industry woes were many too! Not only does it suffer from fund crisis, the major related factor is in delay of completion of projects.

A slowdown in the economic situation in the world adversely affects the earning power of the masses. In many cases, there have been drops in employment as slowdown here in India can be directly linked to global economic situations. Thus, the generation and circulation of free funds to finance industries such as construction and infrastructure is adversely affected. Government funding, too, slows down causing a disruption that is difficult to manage with fund generation through external sources.

As a result projects got delayed. And that led to major cost overruns! It is estimated that only 25 per cent of projects come within 10 per cent of the original deadline. Subcontractors attribute delays and change orders to design-induced rework. Companies submit project proposals based on the availability of resources. Therefore, delayed projects will cause a kink in the entire scheduling and resource management of a construction company.

The decline in cash flows led to companies borrowing at higher rates to pay incoming bills — one of the common problems faced by all construction companies in the recent years.

As a result, it became difficult to prevent the growing menace of bad loans. Economic slowdown also leads to disruption of skilled labour particularly in the construction and building industries. In fact, there is slow but steady growth in the availability of adequate skilled labour for the industry. There is dearth of labour because many young and upcoming workers are finding placements in less labour intensive jobs. Labour migration has been one of a reasons for project delays leading to cost over runs. And it happened to the construction industry making it one of the major contributors to the NPA mess in the country.

With cost and schedule overruns becoming the norm in construction, the Integrated Project Delivery (IPD) is gaining traction. IPD brings together the owner, architect, general contractor and major subcontractors at the beginning of the project to collaborate on designs, schedules, and costs. Because subcontractors perform the majority of labour on commercial projects, aligning their interests with the owner and designer creates a streamlined integrated labour delivery method. Subcontractors serve as the subject matter experts, who are responsible for the articulation of the intricate and complex designs and need a seat at the design table to ensure a building is built as intended. A project based on an integrated labour delivery model connects all the stakeholders to improve communications, accountability and productivity.

Telecom woes

The woes of the telecom sector got highlighted considerably in the Economic Survey Report of 2017-18, which stated that the industry is passing through stress due to a huge debt pile, tariff war and irrational spectrum costs. It called for policy measures to minimise over-bidding of assets during auctions

The survey also spells out that entry of Reliance Jio with free voice and data led to a brutal price war in the telecom industry. The competition shifted from cheaper calls to cheaper data. This hurt revenue and profitability of incumbents in the midst of ballooning debts and increased the sector's share of non-performing assets in the banks considerably. This is a cause for worry.

The competition forced telecom companies to cut voice call rates and costs. It trapped telecom companies with high interest rates. What was worrying is that the share of the telecom sector in the non-performing assets (NPAs) began to increase. The share of NPAs of telecom sector in total NPAs of infrastructure sector increased to 8.7 per cent in 2016-17 from 5 per cent in 2015-16.

The problem of growing NPA in the sector also escalated with the slowdown in making fresh investments from financial institutions and the fall in foreign direct investments. In fact, the almost free flow of foreign investments to the telecom sector had created a regime where costs of acquisition remained high. So when the credit flow was hit and the free flow of foreign funds began to dry up because of various factors in the world markets, it became difficult for Indian companies to remain in the pink of their health.

The sector has debts of nearly ₹5 lakh crore and the banking sector, which pegs debt at ₹7.29 lakh crore, is worried that tough competition will lead to defaults.
The crisis has also severely impacted investors, lenders, partners and vendors of these telecom companies.

The mobile industry in India accounts for more than 6.5 per cent of India's GDP, and employs over four million people directly and indirectly. India's telecommunication network is the second largest in the world by number of telephone users of both fixed and mobile phones.

It is estimated that there are 1.19 billion subscribers as of September, 2018. It has one of the lowest call tariffs in the world offered by mega telecom operators and hyper-competition among them. By the end of July 31, 2018, India had the world's second largest internet user-base with 460.24 million subscribers in the country. The Indian mobile economy is growing rapidly and will contribute substantially to India's Gross Domestic Product (GDP).

Indian telecom industry underwent a high pace of market liberalisation and growth since the 1990s and now has become the world's most competitive and one of the fastest growing telecom markets.

With 512.26 million internet subscribers by the end of June 2018, India ranks as the world's second largest market in terms of total internet users.

Moreover, in 2017, India surpassed USA to become the second largest market in terms of number of app downloads.

Over the next five years, rise in mobile-phone penetration and decline in data costs will add 500 million new internet users in India, creating opportunities for new businesses.

Liberalisation of Indian telecommunication in industry started in 1981, when the then prime minister signed contracts with Alcatel CIT of France to merge with the state owned Telecom Company (ITI). The proposal did not see the light of the day but paved the way for foreign investments and technology flowing in.
Later, the liberal and reform policies of the Government of India, along with strong consumer demand, have been instrumental for the rapid growth of the Indian telecom sector. The government has enabled easy market access to telecom equipment and a fair and proactive regulatory framework that has ensured availability of telecom services to consumer at affordable prices. The deregulation of Foreign Direct Investment norms made the sector one of the fastest growing and a top five employment opportunity generator in the country.

The government has fast-tracked reforms in the telecom sector and continues to be proactive in providing room for growth for telecom companies.

Some of the other major initiatives taken by the government are as follows:

* The Government of India has come out with a new National Telecom Policy 2018 in lieu of rapid technological advancement in the sector over the past few years. The policy has envisaged attracting investments worth US$ 100 billion in the sector by 2022.

* The Department of Information Technology intends to set up over one million internet-enabled common service centres across India as per the National e- Governance Plan.

* FDI cap in the telecom sector has been increased to 100 per cent from 74 per cent. Out of 100 per cent 49 per cent will be done through automatic route and the rest will be done through the Foreign Investment Promotion Board approval route.

* FDI upto 100 per cent is permitted for infrastructure providers offering dark fibre, electronic mail and voice mail.

* The Government of India has introduced Digital India programme under which all the sectors such as healthcare, retail, etc. will be connected through internet.

Revenues from the telecom equipment sector are expected to grow to US$ 26.38 billion by 2020. The Indian government is planning to develop 100 smart city projects, where IoT would play a vital role in development of those cities. The National Digital Communications Policy 2018 has envisaged attracting investments worth US$ 100 billion in the telecommunications sector by 2022. The Indian Mobile Value-Added Services industry is expected to grow at a CAGR of 18.3 per cent during the forecast period 2015–2020 and reach US$ 23.8 billion by 2020. App downloads in India are expected to increase to 18.11 billion in 2018F and 37.21 billion in 2022F.

Thus, a mammoth industry such as Telecom heading towards stress and creating bad debts is a major cause of concern, particularly because of the fact that its growth and expansion is linked to investments of large amounts.

IBC in the Telecom Sector

Supratim Sarkar

Executive Vice President & GH of Project Advisory & Structured Finance Group of SBI Capital Markets Limited ("SBICAP")

Indian Telecom Landscape

India is the second largest telecommunications market in the world with ~1.2 billion subscribers. India presents one of the biggest markets for Telecom Operators as well as Telecom Equipment Vendors with capital expenditure by the sector of ₹ 79,000 crore estimated in FY 2019.

However, since entry of Reliance Jio (RJio) in September 2016, there has been major consolidation in the sector. Companies like Reliance Communication (RCOM), Tata Tele, Aircel, Videocon, Telenor and Sistema have either closed down their operations or sold their business to an existing operator; Vodafone and Idea have merged. This consolidation has led to only 3 private services providers' viz. RJio, Airtel and Voda-Idea apart from the State owned BSNL and MTNL.

The License fee and Spectrum charges collected by DoT from the industry has reduced from ₹22, 492 crore in FY 17 to ₹17,314 crore in FY 18. It has further dipped to ₹7,889 crore for first half of FY 19 thereby highlighting the stress in the sector due to aggressive competition.

The Insolvency And Bankruptcy Code, 2016 (IBC)

The Insolvency and Bankruptcy Code (IBC) has brought $14.3 billion worth of distressed assets to the Mergers and Acquisition (M&A) table since becoming a law. As per a PwC report, distressed assets accounted for 12 per cent of total M&A value since IBC is in force.

IBC For Telecos — Not What The Doctor Ordered

While IBC has come as a relief to Creditors across industries, Telecom industry owing to its peculiar nature as explained below might be amongst the few exceptions to this.

Spectrum Holding

Spectrum in India is licensed to the operators by the Department of Telecommunications (DoT) on behalf of the GoI, who owns it. Before liberalisation, a Tri-Party agreement used to be entered into between the DoT, Operator and the Lenders for the Lender to step-in in the event of default by the Telecom Operator. However, under the Unified Licenses Agreement, DoT has the right to revoke/ suspend the license granted to the operator in the event of occurrence of the conditions mentioned in the agreement which include liquidation as well as order to wind up. There is lack of clarity on treatment of such spectrum on transferring it to the buyer at the time of sale in IBC.

Litigation With Regulator/ Govt. Bodies

As an offshoot of litigations with regulator, most of the telecom operators have huge contingent liabilities, which affect Resolution Applicants' ability to ascribe a value to the assets and in turn affect resolution under IBC. The levies on account of transfer of business like Stamp Duty and Goods and Service Tax are high in India. This is apart from peculiar levy of entire sale proceeds being considered as Adjusted Gross Revenue by DoT and therefore subject to License fee and Spectrum Usage charges which can be as high as 12-13 per cent.

Voda-Idea (merged entity of Vodafone & Idea) Chairman has also emphasised on the criticality of resolution of amount locked up due to GST payment under the reverse charge mechanism. With companies facing trouble in implementing the provision, the


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GST Council had decided to keep the mechanism in abeyance till September 30, 2019. However, the amount of ₹30,000 crore collected through such mechanism earlier is still locked up.

Lack Of Enthusiasm From Investors

Stressed assets' M&A has not seen complementing investment landscape in Telecom sector due to overleveraged balance sheets of existing operators, wafer thin margins and uncertain regulatory outlook. Most deals in the sector have been no cash deals and have avoided going to IBC. This is on account of the highly regulatory overhang in the Indian Telecom Sector and also the rapidly changing technology to cater to the data demands of the low-ARPU Indian customers.

Geographical Spread

Due to the large geographical spread of operations, it will be difficult for the Lenders/ RP to take meaningful control of the operations. It is tough even to locate the assets post exodus of employees let alone liquidation of the same.

Even if RP is able to locate them over vast geographical spread, liquidation often is a time consuming and costly affair resulting in erosion of realizable value.

Subscriber Stickiness

With availability of MNP (Mobile Number Portability), tactics of poaching each other's subscribers have led to erosion of the subscribers from the already distressed operator affecting their value. Subscribers and spectrum are two important components of the Telecom business. With uncertainty on both, the value in buying distressed telecom company under IBC is negligible.

Issues Of Operational Creditors

Due to overleveraged balance sheets, operational creditors may get a raw deal under any resolution process. The operational creditors have a huge role to play in the running of operations of the Company. The networks on which Telecom service run may be completely shut down in case of no visibility of payment to such Operational Creditor. In case of RCOM, asset monetisation plan is in advanced stage in the overall plan of debt resolution outside IBC. However, threat of IBC constantly looms over the Company. With the issues discussed above, Lenders would prefer the resolution to be completed outside of IBC. We have seen that GoI seeks recommendations from experts committee on modification required to IBC to plug loopholes and fine tune it with recent significant amendment being homebuyers being treated at par with financial creditors. It remains to be seen on how typical issues surrounding the Telecom sector are addressed under the IBC keeping the interest of the different class of creditors in mind.

Supratim Sarkar

He is the Executive Vice President & GH of Project Advisory & Structured Finance Group of SBI Capital Markets Limited ("SBICAP"), the investment banking arm of State Bank of India. SBICAP has abeen ranked #1 Globally as Project Finance Mandated Lead Arranger for past many years.

Sarkar has an extensive project finance experience of twenty years across various sectors inter-alia, power, oil & gas and infrastructure. He has successfully lead and executed pioneering transactions in the Indian project finance market such as Petronet LNG Ltd., Gangavaram Port, Dabhol Restructuring, Guru Govind Singh Refinery Ltd., Bharat Oman Refinery Limited, Tata Ultra Mega Power Plant, Tata Steel, Pan India Launch of GSM services of Videocon Ltd, Acquisition of tower portfolio of Aircel for GTL Infrastructure Ltd. Aromatics Project in Mangalore SEZ of ONGC & MRPL Ltd., Yamuna Expressway Project of Jaiprakash Associates Ltd., Essar Steel Debt Consolidation of Essar Steel, Setting up an Integrated Aluminum Project of Vedanta Aluminum Ltd., 1320 MW Domestic coal based power project of Adani Power Rajasthan Ltd.

He has also advised various Governments and Government agencies on various advisory assignments such as Unbundling and Privatisation of Delhi Vidyut Board (DVB), Karnataka State Industrial Development Corporation.

He holds a Bachelor's and Post Graduate Degree in Mechanical Engineering (M. Tech) and Masters in Business Administration (MBA).

We acknowledge his contribution and are thankful for the same.

Textile

India's textiles sector is one of the oldest industries in Indian economy with a size of around USD $150 billion

The textile sector accounts for 6.9 per cent to the stressed loan basket in India. This makes it the third most contributors to the stressed loans according to the bi-annual Financial Stability Report released by the Reserve Bank of India in 2018.

The report highlights the performance of banks and provides insights on the extent to which Indian banking sector is resilient to the stress in the system.

The textile sector saw a major hit due to demonetisation, implementation of GST, rupee appreciation and high domestic cotton prices.

The domestic textile industry, which has been languishing for the last few years now finally began to show some signs of revival. As per the FSR – June 2018, the stressed advance ratio of textile sub-sector has improved in March 2018 from the levels of September 2017. The gross NPA ratio in the industry sector rose from 19.4 per cent to 22.8 per cent during the same period, whereas stressed advances ratio increased from 23.9 per cent to 24.8 per cent.

The performance of the industry has been jeopardised with stiff competition from neighbouring Bangladesh and countries like Thailand and Vietnam. India has raw materials for the industry that comes at a comparatively high cost being dependent on agriculture and farmer price realisation.

Also, the industry suffered from paucity of funds at competitive rates. The decision by banks and other financial institutions to slow down fresh investments in a bid not to increase their bad loan baskets, affected the textile industry as well.

A report by RBI states that the textile sector has reported a high transmission of stress to the banking sector. On the other hand, an expected recovery may come by because of rupee depreciation leading to increased export income, picking up of domestic demand and progressive policies of the government. The report also states that domestic economy appears to be gathering strength, although global commodity price swings and turbulent capital flows are a constant reminder that there can be little scope for complacence.

Among other things, the report said that risks to India's banking sector have increased since the publication of the last Financial Stability Report (FSR) in December 2015, mainly on account of a further deterioration in asset quality and low profitability.
While the credit and deposit growth of scheduled commercial banks (SCBs) slowed significantly during 2015-16, their overall capital to risk-weighted assets ratio (CRAR) level increased between September 2015 and March 2016. The risk-weighted assets (RWA) density declined during this period.

The gross non-performing advances (GNPAs) rose sharply to 7.6 per cent of gross advances in March 2016 from 5.1 per cent in September 2015, largely reflecting


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re-classification of restructured advances to NPAs following an asset quality review (AQR).

Consequently, overall stressed advances rose only marginally to 11.5 per cent from 11.3 per cent during the period, due to a reduction in restructured standard advances ratio from 6.2 per cent in September 2015 to 3.9 per cent in March 2016.

The decks have been cleared for Mukesh Ambani — led Reliance Industries Ltd. to take over textiles player Alok Industries, which owed lenders ₹29,500 crore. The Ahmedabad bench of NCLT approved ₹5000 crore resolution plan submitted jointly by RIL and JM Financial with immediate effect.

Stress In The Textile Sector And Impact Of IBC Code

Supratim Sarkar

Executive Vice President & GH of Project Advisory & Structured Finance Group of SBI Capital Markets Limited ("SBICAP")

Indian Textile Industry

India's textiles sector is one of the oldest industries in Indian economy. The size of industry is around USD $150 billion in India. The domestic textile industry has been languishing for the last two years due to several issues like demonetisation, implementation of GST, adverse Rupee movements, and high domestic cotton prices.

Exports' is an important part of textile industry contributing to around 25 per cent of revenue. However, it has been impacted adversely due to reduction in duty drawback rates, delay in getting GST refunds, delay in Tuff subsidies, Rupee appreciation, tariff benefits enjoyed by countries like Bangladesh and Vietnam etc.

As per the report by RBI, the textile sector has reported a high transmission of stress to the banking sector. The gross non-performing assets (GNPAs) plus restructured standard advances in the banking system remained elevated at 12.1 per cent of gross advances at end-March 2018 to ₹10,35,528 crore, as on March 31, 2018 (Source: RBI's annual report for 2017-18); out of which textile sector accounts for about 5 per cent of GNPA.

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Impact Of IBC 2016

- The Code brings a paradigm shift from a 'Debtors-in-Possession' approach to a 'Creditors-in-Control' approach
- Insolvency test moved from 'erosion of net worth' to 'payment default'
- Single insolvency and bankruptcy framework which replaces all existing bankruptcy laws in India.
- Time bound resolution process at each stage
- A clearly defined distribution of recovery proceeds
- An Insolvency Professional to take over management and control of the Corporate Debtor

Under the IBC code 2016, there have been around 1003 cases that have been admitted to NCLT and around 44 of which have resolution plans approved and 177 cases have been Under Liquidation with 782 cases still in process. This means that a significant number of companies ending up Under Liquidation rather with a Successful Resolution Plan.

With outside investors showing little interest in companies especially in the SMEs and MSMEs and Section 29A of IBC barring the existing promoters from bidding in the process it becomes a concern, as either the Lenders have to accept a proposition with haircut as high as 70 per cent-80 per cent or the company ends up under

Liquidation. Due to the above reasons, there are even cases where a company might have chances of revival but end up being liquidated due to lack of interest from investors.

Impact of IBC on Textile Industries

Some of the major textile industries like Alok Industries Limited, Mandhana Industries Limited, Reid & Taylor India Limited, Garden Silk Mills Limited and JBF industries have been referred to the respective tribunals however; the overall recovery under the CIRP process for textile industry has not been encouraging.

The haircut taken by the Lenders with regards to textile sector has been higher with comparison to some other sectors such as Steel sector. One such case where the lenders have taken a major hit is Alok Industries where the expected recovery is around 17 per cent of what the borrower owed to the Lenders resulting in 83 per cent of haircut and similarly for Mandhana Industries Limited the recovery is expected to be around 45 per cent resulting in 55 per cent of haircut to the Lenders.

As for some of the smaller textile units such as Sanaa Syntex Private limited, Hammerle Textiles Limited, Oasis Textiles Limited, Shree Rajeshwar Weaving Mills Private Limited etc., they have not been able to get buyers/satisfactory Resolution Plans for the approval of CoC/ NCLT and hence are going Under Liquidation. This is due to the limited appetite among the buyers and with very few buyers actually participating in the process, there is no serious competition among them which would result in significant recovery for the Lenders as seen in some of the cases in Steel sector.

The other reason as to why textile sector has not garnered much of interest from potential investors is that generally the textile companies that have been referred to NCLT are integrated companies involved in several sub segments in textile industry, which have long standing infrastructure may need additional capex for running in full capacity. The other possibility is that a Lender who has taken haircut in a particular case might be reluctant to lend for the same company again albeit to new investor, leading to further liquidity crunch. One other reason could be that due to multi segment activities; few of the segments in which such stress companies are dealing in may not be very attractive from strategic investor's perspective.

Textile industry is a very working capital intensive sector and in the present scenario, with banks being reluctant to lend in order to meet RBI's capital adequacy norms, the sector is not able to get timely support and the players are not able to increase their existing operations, further increasing stress in the companies. With as many as 11

Banks have been under Prompt Corrective Action (PCA) facing restrictions under restricted-lending state and have had to cut lending to corporates with an aim to focus on reducing concentration of loans to certain sectors it makes it difficult to find investors under NCLT.

Few other issues in resolving stress in Textile Sector:

- Several strategic investors are interested in forward integration and focus more on established Brand and existing marketing set-up/ prowess of the company instead of only stand-alone manufacturing activities

- One of the other reasons being the capital subsidy provided on erection of new plants, by states like Maharashtra and Gujarat, under different schemes such as for Self-Financed projects, plants with Green initiatives or plants in underdeveloped regions etc. which further reduces the interest of potential investors in already existing industries. The subsidized cost of setting a new textile unit along with cheaper power costs makes it more financially viable than acquiring an existing textile company with used machinery at location where power is costly

- Weaving segment in industry is considered as Loss making division due to heavy competition from unorganised sector, hence does not gather much interest The immediate need is to make the sector attractive to revive it out of stress, be it via NCLT or any other Resolution Process. The industries in the sector need funds for meeting their working capital requirements and run operations at an optimum level in order to reduce stress in the sector. Improvement in duty drawback rate and timely refund of GST credit will also be helpful for the sector. It is understood that government has proposed to ease curbs on Promoters of SMEs and MSMEs with turnover of around ₹250 crores for bidding in their own company.

This can be a positive move keeping in mind that, these businesses mainly interests the promoter of the company rather than other resolution applicants. Based on the above it is observed that the Lenders might prefer going for restructuring with the same promoter or with other resolution methods such as sale to ARC, rather taking the company to NCLT. One other point of reluctance in going for NCLT could be that though the time frame for submitting resolution plan is 180-270 days with extension, the final order can drag even upto one year.

NPA in Banks

The NPA crisis has affected performances of Indian banks — they are not profitable and at their best of health

The Balance sheets of banks remained beleaguered with persistent deterioration in the asset quality that has eroded profits and constrained financial intermediation. According to the Reserve Bank of India, banks in India will continue to face deterioration in their non-performing assets or bad loans due to the economic conditions in the current fiscal year.

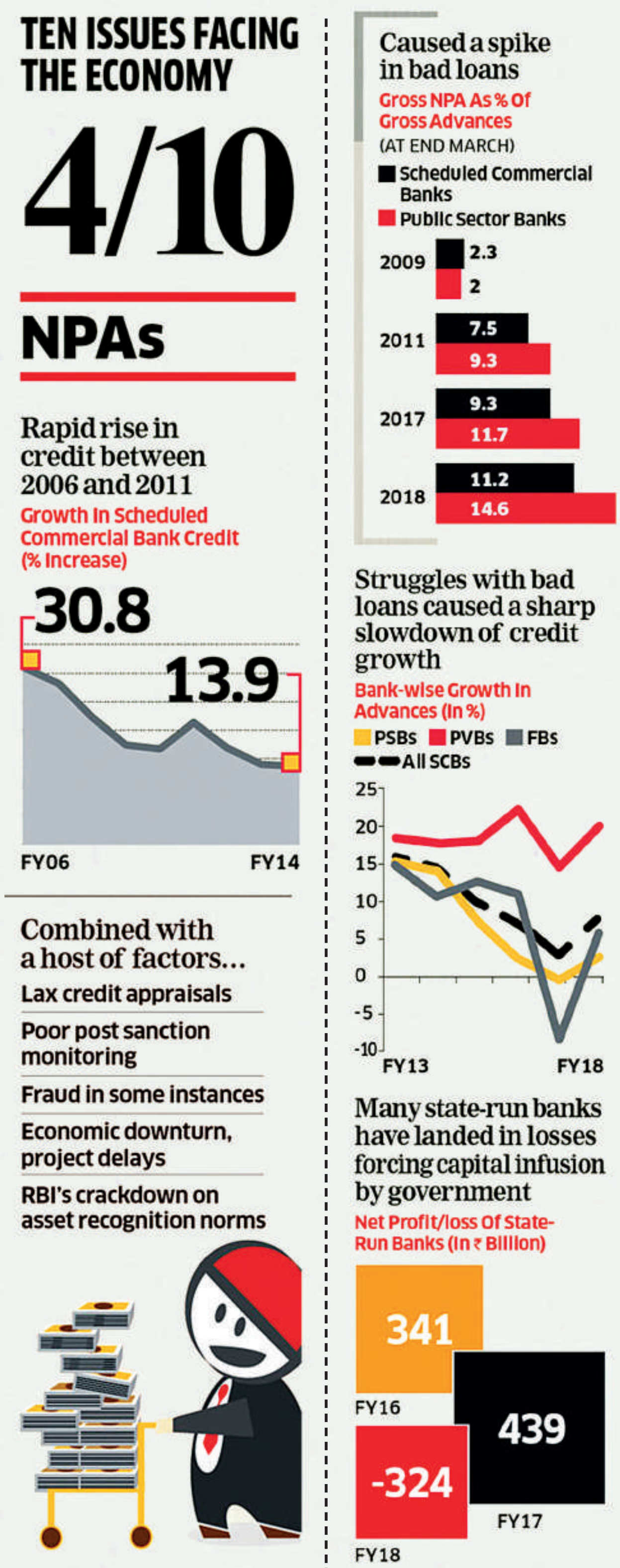
The gross non-performing assets plus restructured standard advances of the banking system remained high at 12.1 per cent of gross advances at end-March 2018.

Budget 2019: Govt wants banks to be profitable and efficient

Going forward, the stress tests carried out by the RBI suggest that under the baseline assumption of the current economic situation prevailing, the gross NPA ratio of scheduled commercial banks may increase further in 2018-19.

The aggregate gross NPAs of SCBs increased primarily as a result of this transparent recognition of stressed assets as NPAs, from ₹3,23,464 crore, as on March 31, 2015, to ₹10,35,528 crore, as on March 31, 2018.

Yet another RBI report indicates that gross non-performing assets in Indian banks, specifically in public sector banks are valued at around ₹400,000 crore, which is a near 90 per



cent of the total non-performing assets. Private sector banks make up the rest.
Write off of bad loans have been a process followed in banks for more than a decade. The write off amount, for both grew significantly between 2017 and 2018.

Reasons for the NPA crisis

BAD LOAN WRITE-OFFS IN LAST 10 YEARS

(Rs/crore)

YEAR	PSU	PRIVATE	TOTAL
2009	1,594	570	2,165
2010	7,828	7,240	15,068
2011	17,729	2,570	20,299
2012	14,614	3,633	18,248
2013	26,524	5,025	31,549
2014	28,920	6,504	35,424
2015	46,179	6,767	52,947
2016	61,121	10,133	71,253
2017	75,929	13,119	89,084
2018	1,20,165	23,928	1,44,093
TOTAL	**400,584**	**79,490**	**480,093**

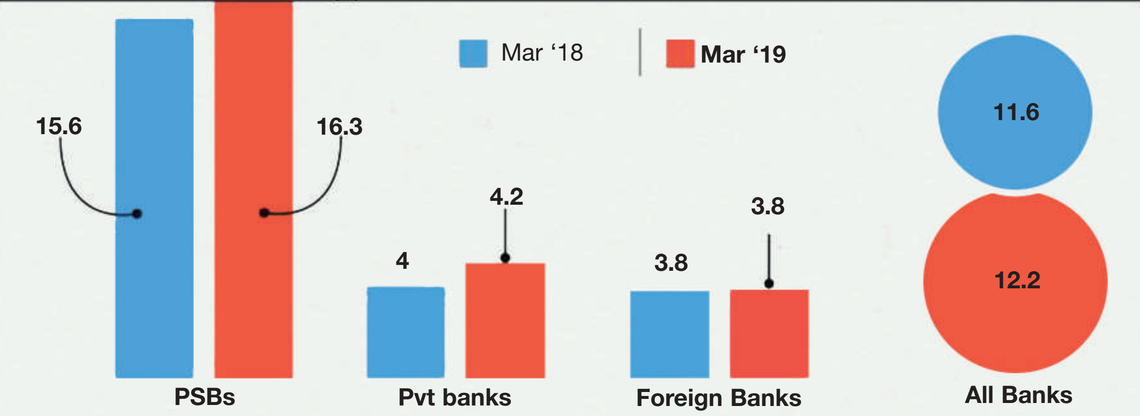
Source : ICRA

Due to the financial crisis in 2008-09, corporate India's profits decreased. It was also a time when the government banned mining projects. The situation became serious with the substantial delay in environmental permits, affecting the infrastructure sector — power, iron and steel — and resulting in volatility in prices of raw materials and a shortage of supply.

The deviation from set lending norms adopted by banks and their inability get out of exposures, especially to the big corporate houses, at times is considered to have created a situation that led to a NPA explosion.
It is expected that through the new institutional mechanisms such as the Insolvency and Bankruptcy Code, the resolve on the part of the government and the RBI to

A GRIM PICTURE

RBI's projection of bank's gross non-performing asset ratios under current economic scenario (%)



PSBs: Publis sector banks

Source : RBI's Financial Stability Report- June'18

THE WRITE-OFF, THE RECOVERY

	Bad loans Written-off by PSBs 2014-2018 (till Dec, 2017 Rs Crore	Recovery from written of Accounts by PSBs 2014-2018 (till Dec, 2017) Rs Crore	Recovery Rate (0%)
UCo Bank	6087	0	0.00
Indian Overseas Bank	10,470	10	0.10
Allahabad Bank	9,533	257	2.70
IDBI Bank Limited	16,568	479	2.89
Corporation Bank	10,790	562	5.21
Bank of India	17,680	1,099	6.22
Bank of Baroda	10,571	915	8.66
State Bank of India	1,02,587	10,396	10.13
Punjab National Bank	27,814	6,270	22.54
Canara Bank	13,917	3,248	23.34
Syndicate Bank	5,363	1,535	28.62
Total*	2,72,558	29,343	10.77

Source : Reserve Bank of India *Total is for all 21 public sector banks.

collectively address the problem of stressed assets is visible. Also, banks will have to make great efforts towards improving efficiency, credit monitoring and risk management.

To this effect the Enhanced Access and Survice Excellence (EASE) programme for Public Sector Banks was launched by the MoF for effective functioning of PSBs. According to the scheme banks will be monitored and measured on their performance across six themes – customer responsiveness, responsible banking, credit off-take, financing and bill discounting of micro, small and medium enterprises, financial inclusion and digitalisation, and human resource development. Under the 'responsible banking pillar' banks are expected to tie up with agencies for Specialised Monitoring for clean and effective post sanction follow up in loans above ₹250 crore.

In June 2018, the Reserve Bank of India asked lenders, mostly comprising PSU banks, to act on a list of 200 companies who had defaulted on loans to banks but were not classified as non-performing assets by others. The directive came two years after former RBI governor Raghuram Rajan started a clean-up process by an Asset Quality Review exercise.

The apex bank's identification of defaulters came at a time when the central government set up a panel to resolve stressed assets in the power sector. One of the main requirements of the panel was to examine in provisioning norms in preventing projects from becoming non-performing assets.

The dole out by the government cannot be considered adequate, as the NPA of banks increased to ₹10 lakh crore by March 31, 2018. Compare this to a figure at the end of March 2014, the same was only ₹2 lakh crore. In the year 2014, the total NPA against total advance was 4.4 per cent, which increased to 11.06 per cent in 2018.

Steps taken to contain the growth of NPAs in banks

Credit Risk Management

This involves credit appraisal and monitoring accountability and credit by performing various analysis on profit and loss accounts. While conducting these analyses, banks should also do a sensitivity analysis and should build safeguards against external factors.

Tightening Credit Monitoring

A proper and effective Management Information System (MIS) needs to be implemented to monitor warnings. The MIS should ideally detect issues and set off timely alerts to management so that necessary actions can be taken.

Amendments to Banking Law to give RBI more power

The present scenario allows the RBI just to conduct an inspection of a lender but doesn't give them the power to set up an oversight commit tee. With the amendment to the law, the RBI will be able to monitor large big accounts and create oversight committees.

More "Hair-cuts" for Banks

For quite some time, PSU lenders have started putting aside a large portion of their profits for provisions and losses because of NPA. The situation is so serious that the RBI may ask them to create a bigger reserve and thus, report lower profits.

Stricter NPA recovery

It is also discussed that the government needs to amend the laws and give more power to banks to recover NPA rather than play the game of "wait- and-watch."

Corporate Governance Issues

Banks, especially the public sector ones, need to come up with proper guidance and framework for appointments to senior level positions.

A cumulative result is expected to create a platform to overcome the strains on lending capacity and efficiently perform their role as financial intermediaries.

The Indian financial system remains bank-dominated, even as the availability of finance from alternative sources has increased in recent years. During 2016-17, bank credit accounted for 35 per cent of the total flow of financial resources to the commercial sector. The persistent deterioration in the banks' asset quality has dented the profitability and constrained the financial intermediation. Consequent deleveraging has resulted in historically low credit growth, although subdued demand, especially from

industry, has also restrained credit off-take. Demonetisation of specified bank notes in November 2016 impacted the banking sector's performance transitorily in the form of a surge of low-cost deposits and abundance of liquidity in the system. This sped up transmission of interest rate reduction and altered banks' balance sheet structures even as they were engaged in managing the process of currency withdrawal and replacement. The Reserve Bank's ongoing regulatory and supervisory initiatives for a time-bound resolution of stressed assets and reviving credit flow to productive sectors, received statutory backing from the Government through various institutional reforms.

At the same time, efforts were also made to augment the capital base of public sector banks to buffer them against balance sheet stress so that they can reinvigorate their primary role of financial intermediation and support inclusive growth. On their part, banks also mobilised capital and fine-tuned their business strategies to remain competitive in the evolving financial landscape. Incidentally, the government recently recapitalised 12 public sector banks by ₹48.000 crore to ease their financial crisis.

In an environment characterised by slowing economic activity mainly in industries and slow demand for domestic products and services, the growth in consolidated balance sheet of banks moderated further during 2016-17. Credit growth fell to a record low of

2.8 per cent pulled down by persistent decline in asset quality which necessitated a sharp increase in provisioning requirements. As a consequence, banks' profitability got adversely impacted.

However, recent trends indicate that almost a year after the Reserve Bank of India asked banks to move to a stricter non-performing asset recognition regime, there are clear signs of a moderation in fresh non-performing assets additions, with many large banks reporting a fall in this number every quarter so far the present fiscal.

New additions to NPAs for State Bank of India, ICICI Bank, Axis Bank and Bank of Baroda were at their lowest in the third quarter ending December 2018 compared to past quite a few quarters. Banks now can seriously think of putting their NPA baggage in the past and work on improving their profitability in the months to come.

Although, the current situation of the NPA is frightening, it cannot be proclaimed that the problem of NPA is an incurable one. There are risks in every business in the world. The banking business is not different. In the current financial year, the strategy which some PSUs have followed successfully in reducing their NPA can be emulated by some more PSUs.

Therefore, PSB's need to act more proactively and select a proper mix of their asset pool (Commercial/ Agriculture/ Retail, etc) to derive an optimum goal of profitability.


IDBI BANK
Bank of Maharashtra
भारत सरकार का उद्यम
एक परिवार एक बैंक
यूनाइटेड बैंक ऑफ़ इंडिया
UNITED BANK OF INDIA
इंडियन बैंक
Indian Bank
विजया बैंक
VIJAYA BANK
(A Government of India Undertaking)
A friend you can bank upon
पंजाब नैशनल बैंक
punjab national bank
देना बैंक
DENA BANK
(A Government of India Enterprise)
Trusted Family Bank
Dena hai to Bharosa hai.
बैंक ऑफ़ बड़ौदा
Bank of Baroda
सेन्ट्रल बैंक ऑफ़ इंडिया
Central Bank of India
"CENTRAL" TO YOU SINCE 1911
इण्डियन ओवरसीज़ बैंक
Indian Overseas Bank
आपकी प्रगति का सच्चा साथी
Good people to grow with
Oriental Bank of Commerce
केनरा बैंक
Canara Bank
Union Bank
of India
विश्वसनीय.
मैत्रीपूर्ण
Faithful.
Friendly
सिंडिकेटबैंक
SyndicateBank
पी.एस.बी.
ANDHRA BANK
Corporation Bank
यूको बैंक
(भारत सरकार का उपक्रम)
UCO BANK
(A Govt. of India Undertaking)

PSU BANKS
OPERATING PROFIT

Sr. No.	BANK MARCH	MARCH 2018	MARCH 2017	GROWTH OVER PREVIOUS YEAR FIGURES IN CR AMOUNT	%
1	State Bank of India	54074.78	50847.90	3226.88	6.35
2	Punjab National Bank	10294.20	14565.16	-4270.96	-29.32
3	Bank of Baroda	12005.55	10975.07	1030.48	9.39
4	Canara Bank	9548.24	8913.89	634.35	7.12
5	Bank of India	7138.91	9732.64	-2593.73	-26.65
6	Union Bank of India	7539.57	7430.1	109.47	1.47
7	Syndicate Bank	3863.85	4233.23	-369.38	-8.73
8	Central Bank of India	2732.98	3088.63	-355.65	-11.51
9	IDBI Bank	7904.52	4618.69	3285.83	71.14
10	Oriental Bank of Commerce	3703.18	4170.13	-466.95	-11.20
11	Allahabad Bank	3438.32	3866.77	-428.45	-11.08
12	Indian Overseas bank	3629.08	3650.21	-21.13	-0.58
13	Indian Bank	5000.99	4000.71	1000.28	25.00
14	Andhra Bank	5361.03	4387.95	973.08	22.18
15	Corporation Bank	3950.41	4439.53	-489.12	-11.02
16	UCO Bank	1334.24	2926.08	-1591.84	-54.40
17	Vijaya Bank	3097.80	2421.15	676.65	27.95
18	Bank of Maharashtra	2191.40	1827.07	364.33	19.94
19	United Bank	1024.06	1552.89	-528.83	-34.05
20	Dena Bank	1171.16	1390.21	-219.05	-15.76
21	Punjab & Sind Bank	1144.71	1241.88	-97.17	-7.82
TOTAL		**150148.98**	**150279.89**	**-130.91**	
AVERAGE		**7149.95**	**7156.19**	**-6.23**	**1.50**

Source : Reserve Bank of India

PSU BANKS
NET PROFIT

Sr. No.	BANK	MARCH 2018	MARCH 2017	GROWTH OVER PREVIOUS YEAR FIGURES IN CR AMOUNT	%
1	State Bank of India	-6547.45	10484.10	-17031.55	-162.45
2	Punjab National Bank	-12282.82	1324.80	-13607.62	-1027.15
3	Bank of Baroda	-2431.81	1383.13	-3814.94	-275.82
4	Canara Bank	-4222.24	1121.92	-5344.16	-476.34
5	Bank of India	-6043.71	-1558.34	-4485.37	287.83
6	Union Bank of India	-5247.37	555.22	-5802.59	-1045.10
7	Syndicate Bank	-3222.84	358.95	-3581.79	-997.85
8	Central Bank of India	-5104.91	-2439.10	-2665.81	109.29
9	IDBI Bank	-8237.92	-5158.14	-3079.78	59.71
10	Oriental Bank of Commerce	-5871.74	-1094.07	-4777.67	436.69
11	Allahabad Bank	-4674.37	-313.51	-4360.86	1390.98
12	Indian Overseas bank	-6299.49	-3416.74	-3416.74	100.00
13	Indian Bank	1258.99	1405.68	-146.69	-10.44
14	Andhra Bank	-3412.53	174.33	-3586.86	-2057.51
15	Corporation Bank	-4053.94	561.21	-4615.15	-822.36
16	UCO Bank	-4436.37	-1850.67	-2585.70	139.72
17	Vijaya Bank	727.02	750.48	-23.46	-3.13
18	Bank of Maharashtra	-1145.65	-1372.51	226.86	-16.53
19	United Bank	-1445.44	219.51	-1664.95	-758.48
20	Dena Bank	-1923.15	-863.63	-1059.52	122.68
21	Punjab & Sind Bank	-743.80	201.08	-944.88	-469.90
TOTAL		**-85361.54**	**473.70**	**-85835.24**	
AVERAGE		**4064.84**	**22.56**	**-4087.39**	**-225.97**

Source : Reserve Bank of India

PSU BANKS
GROSS NPA
IN DECENDING PERCENTAGE ORDER

Sr. No.	BANK	MARCH 2018 AMOUNT	MARCH 2018 %	MARCH 2017 AMOUNT	MARCH 2017 %	GROWTH OVER PREVIOUS YEAR FIGURES IN CR AMOUNT	GROWTH OVER PREVIOUS YEAR FIGURES IN CR %
1	IDBI Bank	55588.26	27.95	44752.59	21.25	10835.67	6.70
2	Indian Overseas Bank	38180.15	25.28	35098.25	22.39	3081.90	2.89
3	UCO Bank	30549.92	24.64	22540.95	17.12	8008.97	7.52
4	United Bank	16552.11	24.10	10951.99	15.53	5600.12	8.57
5	Dena Bank	16361.44	22.04	12618.73	16.27	3742.71	5.77
6	Central Bank of India	38130.70	21.48	27251.33	17.81	10879.37	3.67
7	Bank of Maharashtra	18433.23	19.48	17188.71	16.93	1244.52	2.55
8	Punjab National Bank	86620.05	18.38	55370.45	12.53	31249.60	5.85
9	OBC	26133.64	17.63	22859.27	13.73	3274.37	3.90
10	Corporation Bank	22213.44	17.35	17045.22	11.70	5168.22	5.65
11	Andhra Bank	28124.36	17.09	17669.98	12.25	10454.38	4.84
12	Bank of India	62328.46	16.58	52044.52	13.22	10283.94	3.36
13	Allahabad Bank	26562.79	15.96	20687.83	13.09	5874.96	2.87
14	Union Bank of India	49369.93	15.73	33712.28	11.17	15657.65	4.56
15	Bank of Baroda	56480.39	12.26	42718.70	10.46	13761.69	1.80
16	Canara Bank	47468.47	11.84	34202.04	9.63	13266.43	2.21
17	Syndicate Bank	25758.60	11.53	17609.31	8.50	8149.29	3.03
18	Punjab & Sind Bank	7801.65	11.19	6297.59	10.45	1504.06	0.74
19	State Bank of India	223427.46	10.91	112342.99	6.90	111084.47	4.01
20	Indian Bank	11990.14	7.37	9865.14	7.47	2125.00	-0.10
21	Vijaya Bank	7526.09	6.34	6381.78	6.59	1144.31	-0.25
TOTAL		**895601.28**		**619209.65**		**276391.63**	
AVERAGE		**42647.68**	**16.91**	**29486.17**	**13.09**	**13161.51**	**3.82**

Source : Reserve Bank of India

PSU BANKS
NET NPA
IN DECENDING PERCENTAGE ORDER

Sr. No.	BANK	MARCH 2018 AMOUNT	MARCH 2018 %	MARCH 2017 AMOUNT	MARCH 2017 %	GROWTH OVER PREVIOUS YEAR FIGURES IN CR AMOUNT	GROWTH OVER PREVIOUS YEAR FIGURES IN CR %
1	IDBI Bank	28265.14	16.69	25205.80	13.21	3059.34	3.48
2	United Bank	10316.30	16.49	6591.85	10.02	3724.45	6.47
3	Indian Overseas Bank	20399.16	15.33	19749.32	13.99	649.84	1.34
4	UCO Bank	14082.07	13.10	10703.39	8.94	3378.68	4.16
5	Dena Bank	7838.78	11.95	7735.12	10.66	103.66	1.29
6	Corporation Bank	14077.02	11.74	11692.18	8.33	2384.84	3.41
7	Punjab National Bank	46684.29	11.24	32702.11	7.81	13982.18	3.43
8	Bank of Maharashtra	9641.19	11.24	11229.56	11.76	-1588.37	-0.52
9	Central Bank of India	17377.87	11.10	14217.83	10.20	3160.04	0.90
10	OBC	14282.86	10.48	14117.83	8.96	165.03	1.52
11	Andhra Bank	12636.87	8.48	10354.81	7.57	2282.06	0.91
12	Union Bank of India	24326.31	8.42	18832.10	6.57	5494.21	1.85
13	Bank of India	28207.27	8.26	25305.05	6.90	2902.22	1.36
14	Allahabad Bank	12229.13	8.04	13433.51	8.92	-1204.38	-0.88
15	Canara Bank	28542.40	7.48	21648.98	6.33	6893.42	1.15
16	Punjab & Sind Bank	4607.87	6.93	4375.08	7.51	232.79	-0.58
17	Syndicate Bank	13239.46	6.28	10410.98	5.21	2828.48	1.07
18	State Bank of India	110854.70	5.73	58277.38	3.71 5	2577.32	2.02
19	Bank of Baroda	23482.65	5.49	18080.18	4.72	5402.47	0.77
20	Vijaya Bank	5021.26	4.32	4118.16	4.36	903.10	-0.04
21	Indian Bank	5959.57	3.81	5606.57	4.39	353.00	-0.58
TOTAL		**452072.17**		**344387.79**		**107684.38**	
AVERAGE		**21527.25**	**9.65**	**16399.42**	**8.10**	**5127.83**	**1.55**

Source : Reserve Bank of India

PVT SECTOR BANKS
OPERATING PROFIT

Sr. No.	BANK	MARCH 2018	MARCH 2017	GROWTH OVER PREVIOUS YEAR FIGURES IN CR AMOUNT	%
1	HDFC Bank	32624.81	25732.39	6892.42	26.78
2	ICICI Bank	24741.53	26486.74	-1745.21	-6.59
3	Axis Bank	15594.48	17584.52	-1990.04	-11.32
4	Yes Bank	7748.11	5847.66	1763.30	29.46
5	Kotak Mahindra Bank	7158.17	5984.81	1310.51	22.41
6	Indus Ind Bank	6656.11	5451.01	1205.10	22.11
7	Federal Bank	2291.03	1924.91	366.12	19.02
8	South Indian Bank	1480.79	1214.59	266.20	21.92
9	Karnataka Bank	1473.17	995.80	477.37	47.94
10	IDFC Bank	1263.40	1753.46	-490.06	-27.95
11	RBL Bank	1331.07	920.41	410.66	44.62
12	Lakshmi Villas Bank	355.38	634.06	-278.68	-43.95
13	Development Credit Bank	524.97	286.35	238.62	83.33
14	Dhanlakshmi Bank	146.18	94.07	52.11	55.39
15	Catholic Syrian Bank	74.32	151.71	-77.39	-51.01
16	Karur Vysya Bank	1777.32	1570.97	206.35	13.14
17	City Union Bank	1207.75	993.74	214.01	21.54
18	Bandhan Bank	2430.11	1792.91	637.20	35.54
TOTAL		**108878.70**	**99420.11**	**9458.59**	
AVERAGE		**6048.82**	**5523.34**	**525.48**	**16.80**

Source : Reserve Bank of India

PVT SECTOR BANKS

NET PROFIT

Sr. No.	BANK	MARCH 2018	MARCH 2017	INCREASE/ DECREASE OVER PREVIOUS YEAR FIGURES IN CR	
				AMOUNT	%
1	HDFC Bank	17486.75	14549.66	2937.09	20.19
2	ICICI Bank	6777.42	9801.09	-3023.67	-30.85
3	Axis Bank	275.68	3679.28	-3403.60	-92.51
4	Yes Bank	4224.56	3339.89	813.06	23.83
5	Kotak Mahindra Bank	4084.30	3411.50	744.41	22.29
6	Indus Ind Bank	3605.99	2867.89	738.10	25.74
7	Federal Bank	878.85	830.79	48.06	5.78
8	South Indian Bank	334.89	392.50	-57.61	-14.68
9	Karnataka Bank	325.61	452.26	-126.65	-28.00
10	IDFC Bank	859.30	1019.74	-160.44	-15.73
11	RBL Bank	635.09	446.05	189.04	42.38
12	Lakshmi Villas Bank	-584.87	256.07	-840.94	-328.40
13	Development Credit Bank	245.34	199.68	45.66	22.87
14	Dhanlakshmi Bank	-24.87	12.38	-37.25	-300.89
15	Catholic Syrian Bank	-97.47	1.55	-99.02	-6388.39
16	Karur Vysya Bank	345.67	605.98	-260.31	-42.96
17	City Union Bank	592.00	502.77	89.23	17.75
18	Bandhan Bank	1345.56	1111.95	233.61	21.01
TOTAL		**41309.80**	**43481.03**	**-2171.23**	
AVERAGE		**2294.99**	**2415.61**	**-120.62**	**-391.14**

Source : Reserve Bank of India

PVT SECTOR BANKS

GROSS NPA

IN DECENDING PERCENTAGE ORDER

Sr. No.	BANK	MARCH 2018		MARCH 2017		GROWTH OVER PREVIOUS YEAR FIGURES IN CR	
		AMOUNT	%	AMOUNT	%	AMOUNT	%
1	Lakshmi Villas Bank	2694.21	9.98	640.19	2.67	2054.02	7.31
2	ICICI Bank	54062.51	8.84	42551.54	7.89	11510.97	0.95
3	Catholic Syrian Bank	764.13	7.89	600.10	7.25	164.03	0.64
4	Dhanlakshmi Bank	469.30	7.35	315.60	4.78	153.70	2.57
5	Axis Bank	34248.64	6.77	21280.48	5.04	12968.16	1.73
6	Karur Vysya Bank	3015.76	6.56	1483.81	3.58	1531.95	2.98
7	Karnataka Bank	2376.07	4.92	1581.59	4.21	794.48	0.71
8	South Indian Bank	1980.30	3.59	1149.01	2.45	831.29	1.14
9	IDFC Bank	1779.06	3.31	1542.10	2.99	236.96	0.32
10	City Union Bank	856.55	3.03	681.98	2.83	174.57	0.20
11	Federal Bank	2795.62	3.00	1727.05	2.33	1068.57	0.67
12	Kotak Mahindra Bank	3825.38	2.22	3571.61	2.59	2098.33	-0.11
13	Development Credit Bank	369.03	1.79	254.20	1.59	114.83	0.20
14	RBL Bank	566.73	1.40	356.84	1.20	209.89	0.20
15	HDFC Bank	8606.97	1.30	5885.66	1.05	2721.31	0.25
16	Yes Bank	2626.80	1.28	2018.56	1.52	2540.54	0.77
17	Bandhan Bank	373.14	1.25	86.26	0.51	286.88	0.74
18	Indus Ind Bank	1704.91	1.17	1054.87	0.93	650.04	0.24
TOTAL		**123115.11**		**86781.45**		**40110.52**	
AVERAGE		**6839.73**	**4.20**	**4821.19**	**3.08**	**2228.36**	**1.12**

Source : Reserve Bank of India

IBC & NCLT : A mode of ensuring right 'Time' value of 'Money' for the Banker

Soumya Kanti Ghosh

Group Chief Economic Advisor,
State Bank of India.

The Background

As kids, we were told that "Time and Tide wait for none." This holds good even now and would continue to hold in future. In the industry, the value of money and time is well understood when stressed assets and profitability has become a major point of discussion.

The Banking Business

The pure business of banking demands generation of resources (by securing liabilities in the form of Deposits) and deployment of resources (by giving advances and investments). The income earned from deployment is used for funding the cost of liabilities. What happens if the income generation gets impacted? How would we fund the liabilities? There are many such questions.

The fact of the matter is that any deployment of fund is done by virtue of deposits and it is no big science to understand that any deposit mobilised today must be repaid someday. The important point, however, is that at any point of time we should be having resources to pay back the liabilities. What if there is a gap? For addressing any perceived gap, there are Regulators and Government who by way of regulations and legislations ensure that any such outliers in this ideal set-up are handled by all means to recover the money at stake.

The Current Resolution Framework

There have been many loan restructuring programmes in the past, which have been done away with. The schemes such as Corporate Debt Restructuring, S4A, Strategic Debt Restructuring, and Flexible Structuring of Existing Long Term Project Loans along with Joint Lenders Forum have been disbanded. The Regulator has instead made resolution of defaults time bound with the Insolvency and Bankruptcy Code (IBC) becoming the main tool to deal with defaulters.

Introduced in May 2016, the Insolvency and Bankruptcy Code (IBC) is a game changer in the resolution of NPAs in India because it provides a framework for time-bound insolvency resolution (180 days extendable by another 90 days) with the objective of promoting entrepreneurship and availability of credit while balancing the interests of all stakeholders. The IBC represents a paradigm shift in which creditors take control of the assets of the defaulting debtors, in contrast to the earlier system in which assets remained in possession of debtors till resolution or liquidation.

Government has notified Insolvency and Bankruptcy code, 2016 post substitution of six decades old Companies Act 1956 by new enactment of Companies Act 2013 and has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 (18 of 2013) w.e.f. 01st June 2016. The intent of the code is to address the delay and complexities of the various extant instruments/forum available in hands which include High Courts, the Company Law Board (CLB), the Board for Industrial and Financial Reconstruction (BIFR) and Debt Recovery Tribunal (DRT), SARFAESI etc. with an aim to enhance the value of the assets and maximize recovery to the creditors.

The most important point of the code is it seeks to separate commercial aspects of the insolvency proceedings from judicial aspects. While Insolvency Professionals will deal with commercial aspects such as management of the affairs of the corporate debtor, facilitating formation of committee of creditors, organising their meetings, examination of the resolution plan, etc., judicial issues will be handled by NCLT. This would reduce the burden on judiciary and would eliminate delays.

The intent is to have a time-bound settlement of insolvency, faster turnaround of businesses in commercial viability and creation of a database of serial defaulters. Further, the code will make it easier for financial institutions and banks to deal with non-performing assets (NPAs) and have a faster and non-invasive resolution process.

Present Status

As per the latest available number with IBBI, 1198 cases have been admitted up to Sept 2018, wherein 382 cases are being closed either by way of appeal/ review, Resolution plan, Liquidation etc. and 816 cases are ongoing the process (details in table).

Corporate Insolvency Resolution Processs						
Quarter	No. of CIRPs at the beginning of the Quarter	Admitted	Closure by			No. of Corporates undergoing Resolution at the end of the
			Appeal / Review	Approval of Resolution Plan	Commencement of Liquidation	
Jan-Mar, 2017	-	37	1	-	-	36
Apr-Jun, 2017	36	129	8	-	-	157
July-Sept, 2017	157	231	15	2	8	363
Oct-Dec, 2017	363	147	33	8	24	445
Jan-Mar, 2018	445	194	14	13	57	555
Apr-June, 2018	555	244	18	11	47	723
July-Sept, 2018	723	216	29	18	76	816
Total	**NA**	**1198**	**118**	**52**	**212**	**816**
Source: IBBI, Data compiled from details available on NCLT Website						

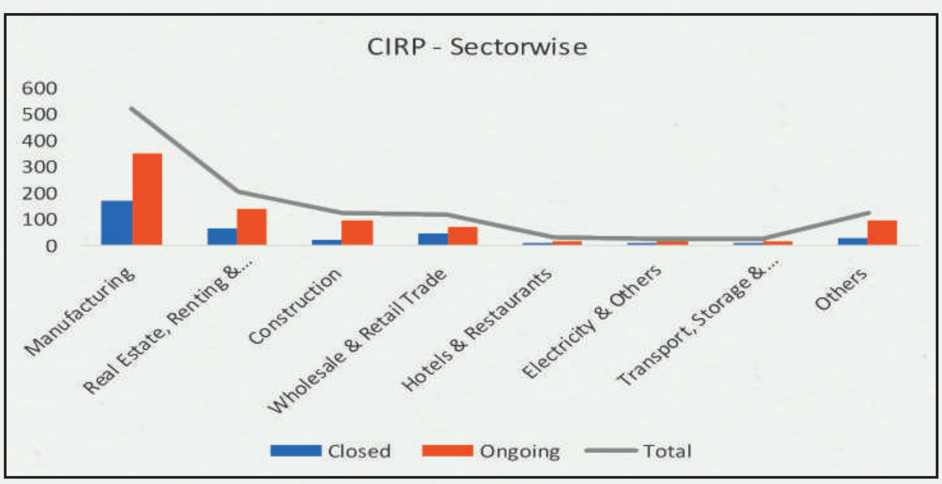
It is also observed that out of 1198 cases admitted, around 460 cases i.e. 38 per cent are initiated by financial creditors, whereas 48 per cent i.e. 576 cases are initiated by operational creditors and remaining 14 per cent by corporate debtors.

Out of 52 resolved cases, upto Sept 2018, from the total claim admitted by Financial the haircut was 54 per cent.

Status of CIRPs - Sept 2018		
Status of CIRPs	Number of Cases	
Admitted	**1198**	
Closed on Appeal/ Review	118	
Closed by Resolution	52	
Closed by Liquidation	212	
Ongoing CIRP	**816**	
> 270 days	238	29%
> 180 days ≤ 270 days	158	19%
> 90 days ≤ 180 days	211	26%
≤ 90 days	209	26%
Source: IBBI		

Sector-wise break-up of Cases Admitted for Corporate Insolvency Resolution Process (CIRP)

Out of total 1198 admitted cases, 522 cases are from manufacturing sector which includes basic metal, chemicals, textiles etc. followed by Real estate, Construction etc. (see chart)



The Infrastructure Gap

As of now, the Central Government has constituted 11 (eleven) benches of the NCLT in exercise of its powers under sub-section (1) of section 419 of the new Companies Act, 2013. Of the said 11 benches, two are in New Delhi including one Principal bench, and one each at Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. Though in few center additional benches have started operating but not in commensurate with the pending as well as flow of cases.

Presently there are more than eleven lakh active companies are operating in the country across region and to cater the them we feel there is a need to address the infrastructure gap not only with more benches but also with appropriate support resources for efficient delivery of cases.

Status Of 12 Large Cases In RBI 1st List

Out of twelve large accounts resolutions initiated by the banks as directed by the RBI with an outstanding claim of ₹3.45 lakh crore, liquidation value of ₹73220 crore, only four cases have been resolved so far i.e. Electrosteel Steels Ltd, Bhushan Steel Ltd., Monnet Ispat and Energy Ltd. and Amtek Auto Ltd. We can observe from the status of the 12 large cases that the infrastructure gap is one of the major reason for pendency. Of course, the debate on the spirit of the code and dual responsibility of interpretation of the law and enhancing the asset value and realisation are still ongoing and need to be ironed out at the earliest.

Some Latest Observation

- IBBI is believed to be thinking of including Operational Creditors (OCs) as part of the Committee of Creditors CoCs). Right now OCs are kept out of the CoC and they are dealt with separately by the insolvency resolution professional

- The National Company Law Appellate Tribunal has held that financial creditor can proceed against corporate guarantor even before proceeding against corporate debtor.

IBC - A Better Recovery Tool Then Exiting Mechanism

The average recovery through mechanisms that existed before IBC viz., the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest (SARFAESI) Act, Debt Recovery Tribunals (DRTs) and Lok Adalats has been declining over the years. The average recovery through IBC is greater than these mechanisms and is also improving gradually, pointing to the need and efficiency of such a channel. The average recovery by banks based on the amount filed through the Insolvency and Bankruptcy Code (IBC) was 41.3 per cent in FY18 against 12.4 per cent through other mechanisms such as SARFAESI Act, Debt Recovery Tribunals and Lok Adalats etc. which further improved to 46.1 per cent in H1FY19. This shows that the alternate new methods are proving to be quite effective in ensuring recovery for the Banks.

Conclusive Remarks

With the latest RBI guidelines on Resolution of Stressed Assets Revised Framework dt.12th February 2018 scrapping all the existing resolution framework (such as CDR, SDR, S4A) and pitching for a timebound resolution plan, we now need to establish commensurate Bench strength of the NCLT including one in every State/ UT with adequate support infrastructure to handle the existing/ perceived load. Further, leveraging technology is a must for NCLT for efficient discharge of its role and success of IBC.

Though the code for individual and cross border is yet to be notified, we fell once the same is being notified, there will be full-fledged i.e. complete cycle IBC, as all are interconnected.

Soumya Kanti Ghosh

Soumya Kanti Ghosh is Group Chief Economic Advisor, State Bank of India. Previously, he has worked at the Tata AIA, American Express and ICRA among others. Dr. Ghosh was a member of an Independent Committee set up by the Government on suggesting ways to capture employment data in India. He serves as a member of the Indian Banks' Association's Monetary Policy Group and also provided inputs to Reserve Bank of India's Expert Committee to Revise and Strengthen the Monetary Policy Framework. Dr. Ghosh is also a member of ALM Committee, Product Committee and Risk Management Committee of the Board at SBI. In 2018, Dr. Ghosh has been ranked as one of the Best Individuals in Research in India by the Asset magazine, He has authored several publications on the Indian economy and recently co-authored chapter in 2 books: (a) a chapter entitled " in ASEAN -India Developed and Co-operation Report, 2015 published by Routledge and (b) a chapter entitled " revisiting Global Governance" in Global Economic Cooperation, 2015 published by Springer. Dr. Ghosh received his PhD in Economics from Jawaharlal Nehru University.

We acknowledge his contribution and are thankful for the same.

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IBC & NCLT : What it means for a mid sized PSB

A C Rout

Executive Director of Bank of Maharashtra

Before going in to the intricacies of the subject from the perspective of on midsized PSB, it would be appropriate to understand, in brief, as to what IBC is and what NCLT is beyond mere nomenclature i.e. Insolvency and Bankruptcy code 2016 and National Company Law Tribunal.

Insolvency & Bankruptcy Code 2016

Insolvency & Bankruptcy code 2016, popularly referred as IBC was enacted on 28th May 2016 and partly notified on November 1, 2016. It provides for a forum to oversee all resolution and liquidation proceedings for, corporates, Limited Liability Partnerships including SMEs and insolvency and Bankruptcy process for individuals, partnership firms. The code lays down framework for resolution through either revival or winding up business. The code is also aimed to establish a process driven commercially and professionally. As at present, the provisions applicable to corporate resolution are notified.

The Code seeks to bring uniformity in the jurisprudential approach and also standardise the processes for treatment of bankrupt or insolvent borrowers. Multiplicity of adjudicating forums, overlapping insolvency and restructuring laws, lower monetisation of liquidated assets and the absence of a time-bound insolvency process are some of the key challenges that the Indian economy faces these days. The Code has been enacted at a time when stress in the Indian banking sector has become evident. To ensure stability and economic efficiency of the Indian credit market, it is critical that these issues be addressed. Precisely with this point at focus as also considering the requirement of improvement in India's worldwide ranking in ease of doing business, IBC has been enacted.

The essential idea of the Code is — when a firm defaults on its debt, control shifts from the shareholders/ promoters to a Committee of Creditors to ensure that the insolvency proceedings are taken to its logical end before corporate debtor's assets deteriorate in value. Committee of Creditors (CoC as is commonly referred) comprises financial creditors as well operational creditors. However, right to vote in CoC meetings is available only to the financial creditors. The terms are well defined in the code.

National Company Law Tribunal

National Company Law Tribunal (NCLT) is the Judicial Authority that exercises jurisdiction over matters coming under IBC. NCLT is referred to as Adjudicating Authority under the IBC. NCLTs find its origin under the Companies Act, replacing High Courts exercising powers as Company Courts. Thus, truly speaking NCLT is a judicial forum/mechanism established to deal with company matters falling under the purview of Companies Act. However, after enactment of IBC, NCLT has been entrusted with the functions of Adjudicating Authority under the code.
Now, while shifting focus to the subject matter, it is imperative to take note of certain important factors that have impact on the banking industry in general and significant impact on the midsized PSB, as viewed from the perspective of stressed assets where cases are referred to NCLT under IBC. These are as under:

- Quantum of stressed assets, including SMA accounts. (As envisaged under the IBC, an account can be referred for resolution under IBC on default in repayment of dues irrespective of the fact whether the account is NPA or otherwise).

- Percentage of assets referred under IBC as compared with Gross advances and gross NPAs of the bank.
- Provision coverage required in respect of the assets referred under IBC for resolution.
- Mandate of the Banking Regulator to refer accounts under IBC, for resolution, if banks are unable to resolve the same within the given timeline from reference date.
- Voting share available to the Bank as member of the Committee of Creditors.

The aforesaid issues are illustrative and not exhaustive. There few other factors that also important for PSBs. However, the aforesaid are the one's which have significant impact on the Banking industry.

Let us now deal with the factors each, one by one.

- As regards quantum of stressed assets, it is pertinent to note that presently the provisions as applicable to corporate borrowers are only notified. Thus, truly speaking, as of now, only corporate advances can be referred under the IBC for resolution. It will not be out of place to say that corporate advances are basically large advances occupying significant share in the total advances portfolio of PSU Banks in general and Mid- sized PSU Banks in particular. To express in figures, on an average the percentage of corporate advances to the total advances of a mid-sized PSB would be in the range between 40-60 per cent. Considering the current economic scenario, as prevalent since last 10-12 quarters, there is significant rise in business failure of corporates, resulting in defaults in repayment of dues. Thus, if percentage of corporate advances under stress to the total advances of mid-sized banks is taken in to consideration, on an average it would be in the range of 30-45 per cent, which portfolio falls within the purview of IBC. Needless to state that for the mid-sized PSBs, the quantum is significantly high to have direct impact on profitability for the reasons stated hereinafter.

- While concentrating only on the NPAs, the corporate and industry loans accounted for over 75-80 per cent of the total non-performing assets (NPAs) of the banking sector. Out of the same the share of accounts referred to resolution under IBC pertains to mid-sized banks is whopping in between 30 - 50 per cent. This is a very important aspect in as much as that it has positive as well as negative impact on a Mid-sized PSBs. To elaborate it further, if the accounts get resolved through IBC, it will have significant positive impact through improvement in NPA ratios.

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However, in the eventuality of impossibility of the resolution or failure of the resolution applicants to keep its commitments (like it is happening in one or two accounts presently under CIRP) the impact would be adverse. However, the experience so far is that IBC has positive impact on NPA portfolio of the Bank.

- The provision coverage required is another extremely vital facet of the coin. As is well known, the Banking Regulator mandates the Banks to make 50 per cent provision on secured portion of the advance once the same is referred under IBC for resolution. This has direct adverse impact on Banks profitability considering the fact that major portion of the operating profit is eaten away by provisioning on such accounts. This is all the more significant if we compare the provisioning required to be made on an account categorised as sub-standard or DB1 as per prevalent IRAC norms. Secondly, as already mentioned above, considering the higher percentage of corporate advances vis-a-vis the total advances, the provisioning requirement on such advances is also higher than the other small advances.

There appears no way out from the requirement of higher provisioning, impacting profitability, in view of RBI instructions dated 12/02/2018 whereby reference to IBC is inevitable for accounts with exposure above specific ceiling, if resolution is otherwise not possible within 180 days from the reference date.

What is more significant is the fact that even if X bank do not wish to refer the matter to IBC, it shall still be bound by IBC process, if any one of the eligible applicant (Financial Creditor/ Operational Creditor/ Corporate Debtor) files corporate Insolvency Resolution Process under IBC, thereby adversely affecting its profitability in the form of requirement of provision higher than the normal provisioning essential as per IRAC norms.

- Credit facilities to big corporates, considering the quantum of finance involved, are generally extended/ made through consortium arrangement. As mandated under the framework governing Banks, each and every bank has its own policy for controlling the exposure to a particular industry/ sector. The regulator has also placed restrictions on Banks to have exposure to a particular borrower vis-à-vis its net worth. Considering these restrictions, a mid sized Bank cannot have more than 6-7 per cent of exposure in a total consortium finance made to a particular borrower. Sometimes this percentage is as low as 1.5 to 2 per cent in case the number of members of consortium is more. This percentage plays a significant role in respect of matters referred under IBC. As already mentioned here in above, once the matter is referred under IBC, the control shifts into the hands of CoC. All decisions of the committee of creditors are mandated (as per provisions of IBC) to be taken by a vote of not less than 66 per cent of voting share of the financial creditors. Decisions such as sale of assets, raising interim funding, finalisation of resolution plan, need to be approved by creditors' committee. A given Bank has per cent share in voting commensurate with the exposure it has in total outstanding of the borrower. Thus, in view of what is stated above, a mid sized Bank hardly has any say in decision making process under IBC regime, particularly considering the per cent exposure it has in the total advance to a corporates borrower under consortium which is almost insignificant considering that minimum 66 per cent vote is required for any particular decision to be taken.

  While the above factors are having direct impact on banks, fact cannot be ignored that IBC & NCLT definitely yield good results and give benefits to the Banks.

Key benefits of IBC are:

- Time bound settlement of Insolvency.
- Banks & Asset reconstruction companies being secured creditors are in advantageous position.
- Database of Serial Defaulters will be maintained and information will be disseminated.
- Before IBC coming in to picture, there were many options of resolutions like JLF, SDR, S4A and 5/ 25 which were time consuming. However, the IBC has come out as a game changer; when IBC is triggered by a creditor as and when default happens, it comes with a time frame for resolution

Of late however, as experience goes, despite timelines specified, the CIRPs are not reaching logical conclusions/ resolutions as the matters are getting stuck up and entangled in legal battles. In many cases, the resolution amount is very small except few of accounts and the margin of hair cut is very much on higher side. This has serious adverse impact on overall NPA portfolio of Mid-sized banks. The industry expects that as the law shall evolve over passage of time, good results shall definitely emerge through the IBC & NCLT mechanism.

A C Rout

A C Rout, serves as the Executive Director of Bank of Maharashtra from March, 2017. He brings with him an extensive experience of 35 years in the field of Banking and Finance. As an Executive Director of the Bank, he is instrumental in evolving strategies for changing business scenario, wholesale business lines, Corporate Credit, Human Resources Management, Financial Management & Accounts, Treasury and Investment, Recovery, Stressed Asset Management, IT & Digital Banking and Credit Monitoring.

Professional History:

Prior to his current role, he worked as Chief General Manager (Commercial Banking) in State Bank of Bikaner and Jaipur was responsible for Corporate Credit, Commercial Banking, Human Resource Management, Treasury & Investment, Risk Management and General Administration. He has held variety of leadership positions at State Bank of Patiala, State Bank of Hyderabad and State Bank of Bikaner & Jaipur (now merged with SBI group) He joined as Probationary Officer in State Bank of Hyderabad in 1983.

Education:

A C Rout holds a degree in Master of Business Administration with specialization in Finance from Jawaharlal Nehru Technological University, Hyderabad and Master of Science with specialization in Physics from Utkal University, Bhubaneswar, Orissa. He is a CAIIB from Indian Institute of Banking and Finance.

Professional Interests:

He has been nominated by Bank to attend Global Advanced Management programme conducted at Kellogg School of Management, Chicago, USA in Jan 2018. He also takes active participation in various training programmes of the Bank.

We acknowledge his contribution and are thankful for the same.

Credit Growth & Stress: The Role Of Banks — Musings

Jyoti Ghosh

Deputy MD,
LSI Financial Services

After independence the mandate for the newly formed government under the Prime ministership of Pandit Nehru was to make India self-sufficient and stable in defence, iron and steel, power, infrastructure, telecom and textiles. Heavy industries became the motto for the first few five-year plans. In 1969 most of the activities in these four and five important sectors emanated from investments by the Government. Thereafter during the prime ministership of Late Madam Indira Gandhi, it was found that private entrepreneurs and banks were not keen to invest in heavy industries etc. That shifted the focus and resulted in nationalisation of the banks. In the first phase 14 largest commercial banks were nationalised with effect from July 1969. A second dose of nationalisation of 6 more commercial banks followed in 1980. The stated reason for the nationalisation was to give the government more control of credit delivery. Other important reasons being:

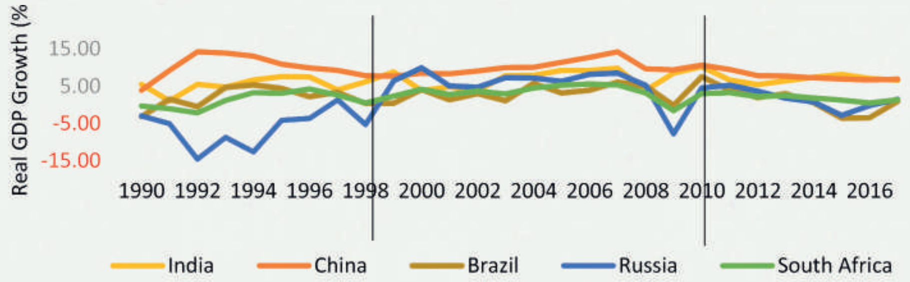
- Control of huge resources
- Attention to priority sector
- Development of backward areas
- Efficiency argument
- Profitability
- Uniform banking policy

- Mobilization of savings and prevention of money lending activities
- Encouraging banking habits and creating banking habitat
- Speedy transfer of funds
- Augmentation of Employment

With the second dose of nationalisation, the Government of India controlled around 91 per cent of the banking business of India. These public sector banks were supposed to lend to large industries so that new facilities for manufacturing of iron and steel, textile and power etc. could happen. As the years rolled by, two more industries came into great focus. One was infrastructure and construction and the other was telecom.

The economic growth of the country till the early 1990s was hovering between 3 per cent to 4 per cent, known as the Hindu Rate of Growth, for major part of the post-independence era. However, from mid-nineties the economic growth of the country's started ramping up to an average of 7 per cent - 8 per cent, with highest of 10.26 per cent in 2010. This growth rate sustained for long and catapulted India into the select group of countries which were known for their high economic growth rates — the so-called Emerging Markets. For the last two decades we are second only to China in rate of growth among the BRICS (Brazil, Russia, India, China, South Africa) nations.

Economic Growth, BRICS 1990-2017



***Source** : IMF, LSI Research*

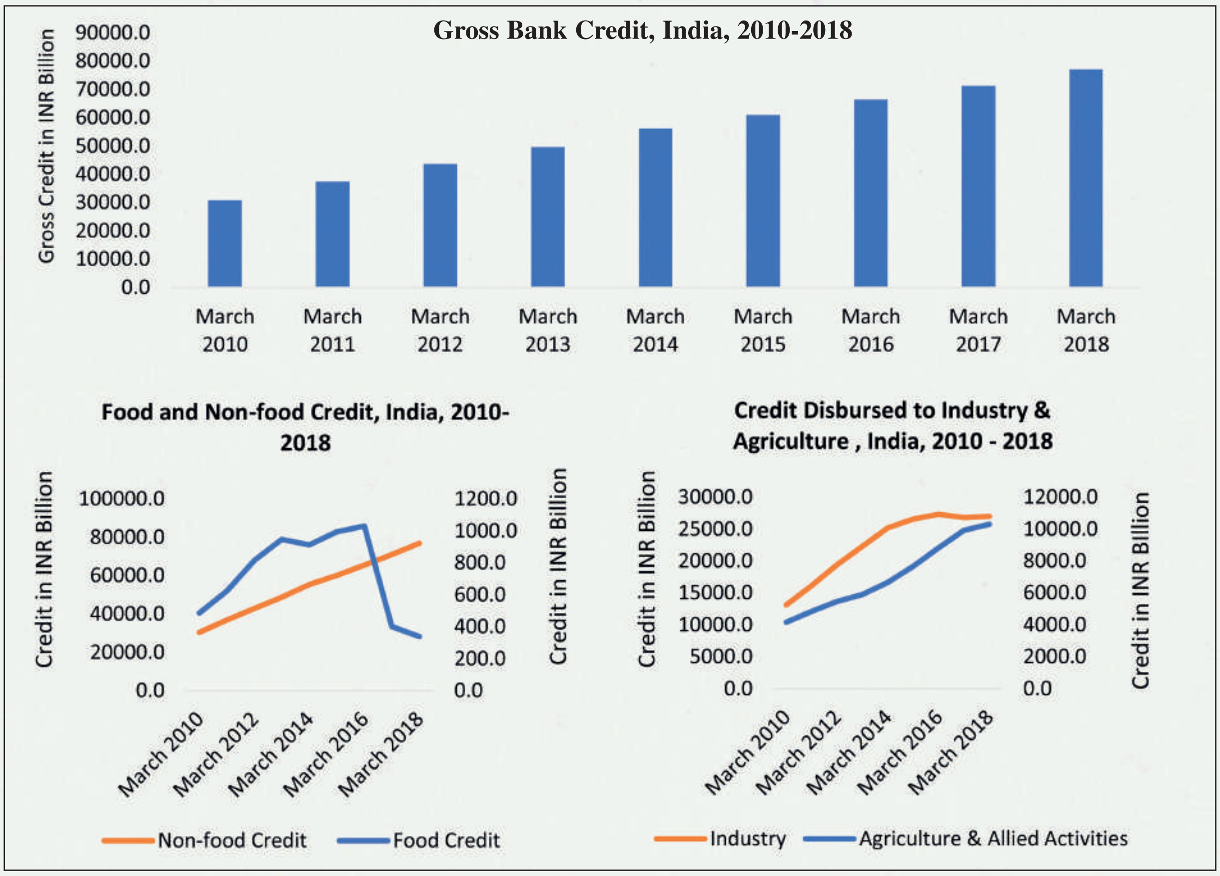
This proves greater participation in financing of all assets which pushed economic growth. The major part of the responsibility was carried out by the public sector banks.

Average Economic Growth of BRICS Nations, 1990 - 2017

Countries	1990-2000	2001-2010	2011-2017
China	10.45	10.57	7.57
India	5.60	7.54	6.83
South Africa	1.84	3.48	1.86
Russia	-3.61	4.93	1.47
Brazil	2.60	3.71	0.49

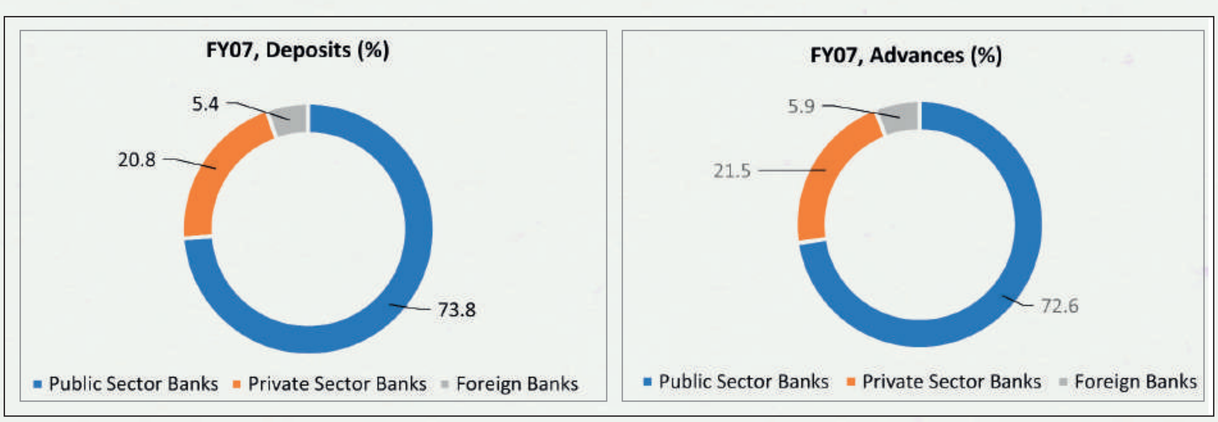
***Source** : IMF, LSI Research*

Bank Credit Disbursement Scenario, 2010 - 2018

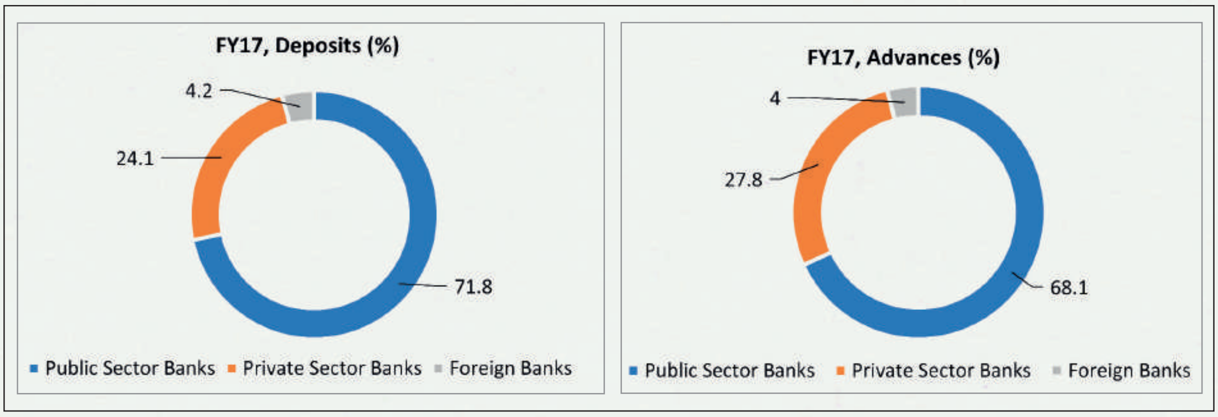


***Source** : RBI, LSI Research*

Over the years, public sector banks have slowly given away their market share to their private sector peers. While the government-owned banks commanded 68.1 per cent of the advances in FY17, at the end of fiscal 2007 their share was 72.6 per cent. In the same period, the private banks have improved their share to 27.8 per cent from 21.5 per cent, while the share of the foreign banks has shrunk to 4 per cent from 5.9 per cent earlier.

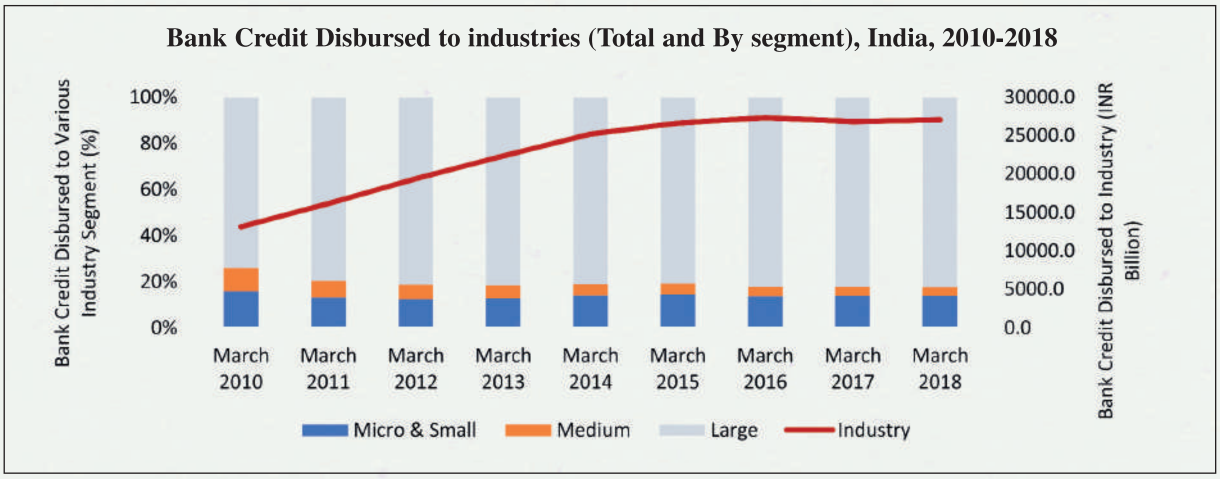


***Source** : http://www.business-standard.com/article/finance/10-years-of-banking-sector-pvt-sector-gains-at-cost-of-public-sector-banks-118032201407 1.html*



Source : *http://www.business-standard.com/article/finance/10-years-of-banking-sector-pvt-sector-gains-at-cost-of-public-sector-banks-118032201407 1.html*

When analysed separately, the industry segments portray a different picture. It shows that while the large and small industry segments witnessed credit growth with a CAGR of 10.89 per cent and 7.68 per cent respectively, credit disbursed to the medium scale industry segment declined by 3.03 per cent during 2010 and 2018.



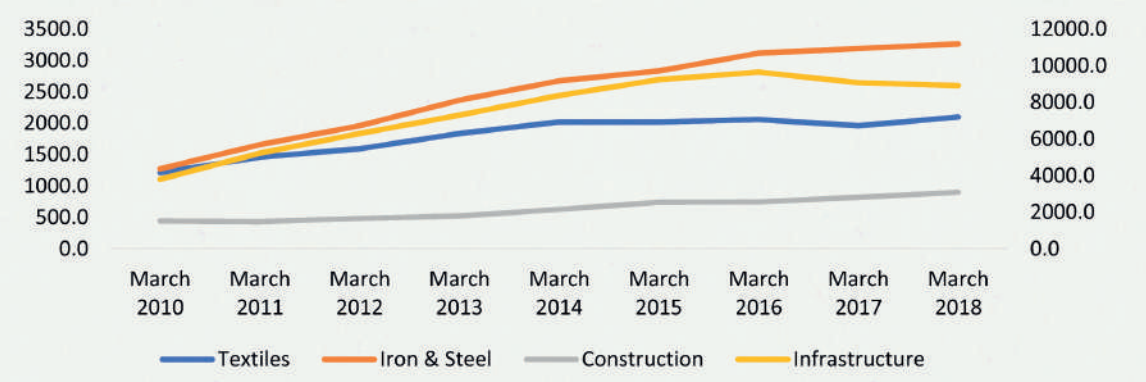
Source : *RBI, LSI Research*

Aggressive growth in credit to sustain demand from the industries created a euphoria in a public sector banks to fast grow their respective balance sheets. To a degree this sentiment was also seen in two of the largest private sector banks. However, the foreign banks, the old private sector banks and some of the new private sector banks kept away from this space. As soon as symptoms of stress and over-heating of certain sectors struck certain industries, the public sector banks bore the brunt of the stress generated in these five major industrial sectors; namely infrastructure, iron and steel, textile, telecommunication and construction.

Bank Credit Disbursed to Different Sectors

In industry-wise disbursement of bank credit, iron and steel saw the highest growth in bank credit with a CAGR of 12.46 per cent. Infrastructure, construction and textile saw the next highest growth in credit with a CAGR of 11.24 per cent, 9.30 per cent and 7.09 per cent respectively in between 2010 and 2018.

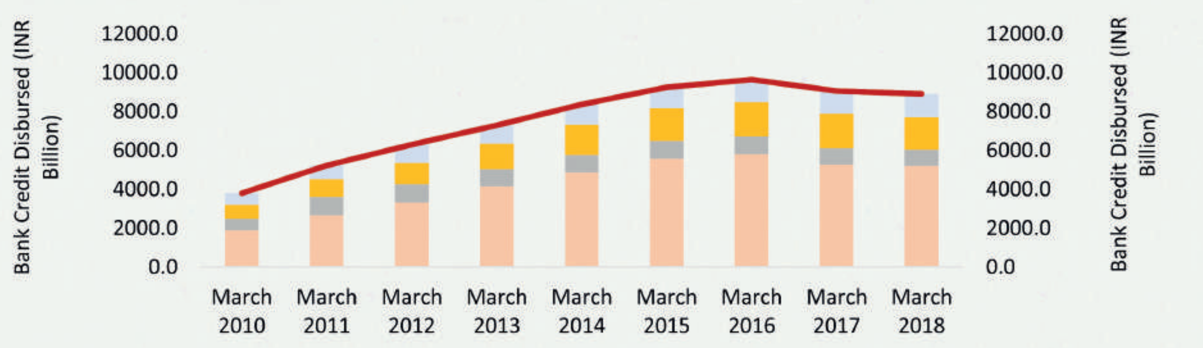
Bank Credit Disbursed to Textile, Iron & Steel and Construction, 2010-2018



***Source** : RBI, LSI Research*

Within the infrastructure sector, the power segment was given the maximum amount of credit followed by roads and telecommunications. The segments recorded a credit growth at a CAGR of 13.56 per cent, 10.75 per cent and 4.52 per cent respectively.

Bank Credit Disbursed to Infrastructure (By segment), India, 2010-2018

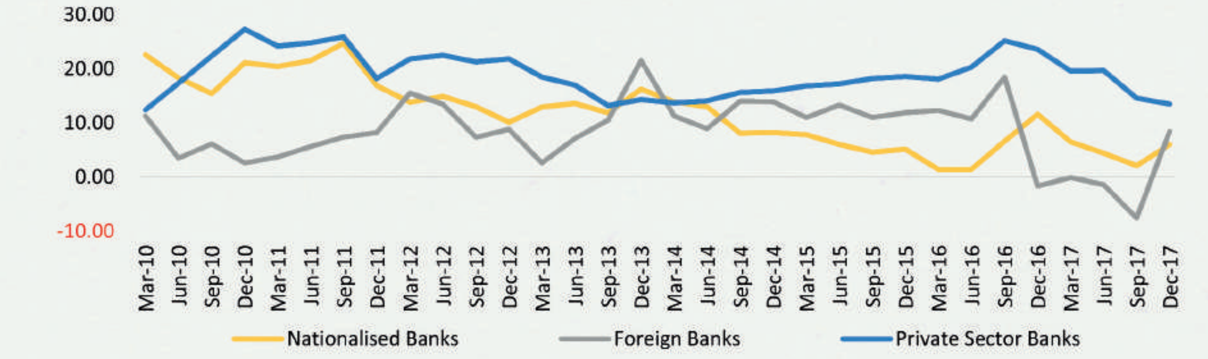


***Source** : RBI, LSI Research*

Note : The red line in the graph denotes the total amount of credit disbursed to the overall infrastructure sector. The upward rising movement of the line between 2010-2016 refelcts a consistent increase in the funding towards this sector, whereas the plateaued shape of the line between 2016-2018 indicates stable but no growth vis-a vis previous years

Between 2010 and 2018, the bank credit advances started slowing FY 2014 onwards. The nationalised banks' credit growth slowed heavily when compared to foreign and private sectors banks owing to the burgeoning amount of NPAs in these units.

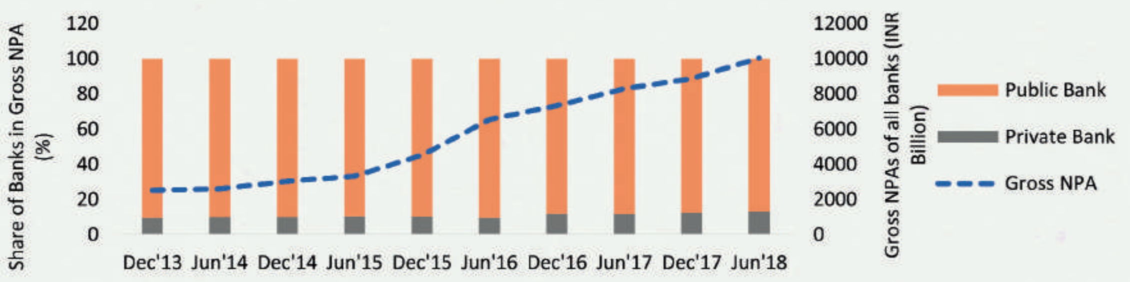
Bank Credit Growth, India, 2010-2017



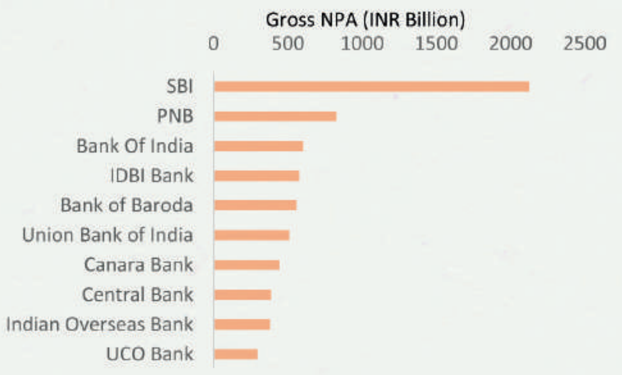
***Source** : RBI, LSI Research*

The regulator, that is RBI, brought in various means of resolving the stress and putting the system back in order. The remedial measures launched by RBI from time to time are Corporate Debt restructuring (CDR), Joint Lenders' Forum (JLF), Strategic Debt Restructuring Scheme (SDR), Scheme for sustainable structuring of Stressed Assets (S4A), etc. Unfortunately, none of these managed to deliver what was envisaged when these rules and regulations were made by the Reserve Bank. In the mean time it was also observed that the defaulting borrowers and the corporates avoided paying back to the banks and keenly used all avenues available to stall recovery procedures and paying back any amounts to the banks where bad debts have

Groaa NPAs of Public and Private Banks, Dec'13-Jun'18, India



Public Sector Banks with higher Gross NPAs till June'18



Private Sector Banks with higher Gross NPAs till June'18

***Note** : Source : http://www.firstpost.com/business/banks-bad-loans-pile-crosses-rs-a0-lakh-crore-up-rs-1-29-lakh-crore-in-march-quarter-the-npa-mess-explained-in-7-charts-3396431.html*

manifested. RBI decided to substitute the existing guidelines with a harmonised and simplified generic framework for resolution of stressed assets.

To further strengthen the hands of the bankers and operational creditors etc. the Insolvency and Bankruptcy code were set up in 2016. The Reserve Bank of India has issued various instructions aimed at resolution of stressed assets in the economy, including introduction of certain specific schemes at different points of time. In view of the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC).

Are the Exposure Norms Prudent Enough?

It has been observed that during boom situations banks get euphoric and might over finance, relax collaterals covers, not stringently follow risk management prescriptions etc. In my opinion the regulator should tweak prudential exposure guidelines to restrict small and mid-sized banks, be it private sector or public sector from over exposure. As per prescription of RBI prudential guidelines the exposure ceiling limits would be 15 percent of capital funds in case of a single borrower and 40 percent of capital funds in the case of a borrower group.

Let us see an example: A bank is lending out 2 amounts of 600 Crores which can be treated in the following two scenarios:

Scenario 1	1 NPA Account	600 Crores
Scenario 2	1 Fraud Account	600 Crores

Now what will be the effect on the annual net profit of the banks of different size under the circumstances of NPA and Fraud while abiding by the exposure norms as prescribed by the RBI? The table below shows this:

Bank Size	Capital (INR Crores)	Net Profit (INR Crores)	Exposure Limit (15% of B) (INR Crores)	Prov. NPA (INR Crores) (15%) 1st Year	Prov. Fraud (100%) (INR Crores)	Effect of Prov. NPA and Prov. Fraud on Annual Net Profit (INR Crores)	Effect of Prov. NPA and Prov. Fraud on Net Profit (%)	Loss
A	B	C	D = 15% of B	E	F	G = C - (E+F)	H = ((E+F)/C) *100	I
Large	15000	2000	2250	90	600	1310	34.5	No
Medium	10000	1500	1500	90	600	810	46	No
Small	5000	500	750	90	600	-190	138	Yes

Observation

While all the exposures are within the limits set by RBI, we see from the table that the net profit of all three banks has reduced. The large and medium size banks are still in profit, so the capital structure of these two banks stays undiminished. In the third case, the small size bank has gone into the net loss. Hence, the Basle III capital adequacy ratio of this bank will reduce.

Therefore, large banks may continue with the exposure prescription of RBI. Medium and small banks should have their internal exposure norms much more stringent than what is prescribed by the Regulator. Can we have the 15 per cent and 40 per cent reduced to say 10 per cent and 25 per cent or even more stringent for banks of small and medium sizes?

Banks should frame comprehensive prudential norms relating to the ceiling on the total amount of real estate loans, single/group exposure limits for such loans, margins, security, repayment schedule and availability of supplementary finance and the policy should be approved by the banks' Boards.

As per the RBI, banks are fixing internal limits for aggregate commitments to specific sectors, e.g. textiles, jute, tea, etc., so that the risk is balanced and evenly spread over various sectors. These limits could be fixed more stringently by the banks having regard to the performance of different sectors and the risks perceived and also the risk appetite and expertise of the concerned bank. The limits so fixed may be reviewed periodically and revised, as necessary. These internal limits should also be stringently maintained and monitored. Small banks may even choose minimal/no exposure, if so desired.

Further, we may consider for few years that small banks majorly to lend to retail portfolio whereby we might be able to ensure the cardinal advisory of any risk mitigation techniques that all eggs should not be put into one basket.

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Recommendations and Way Forward

Reassessment of banks loan sanction model is a must since all banks tend to take the lead Bank assessment in toto without questioning any of the premises and future projections etc. themselves despite the fact that individual assessment has never been waived. Also, sensitive sectors, as advised by RBI from time to time, should have greater focus for the mid-size and small size banks. Ideally, they should not form more than five to ten percent of total credit exposure aggregatively.

Risk management is an inherent part of credit management and they cannot be disassociated at any bank. It is a continuous testing of risk management ratios, terms and conditions, exposure limits etc. viz-a-viz the market perception on that sector and prioritizing our future actions.

On the topic, while personal guarantees and non-project collaterals are mostly not demanded or given by large corporates and mid-size corporates, this should be made incumbent upon all the banks to at least call for personal guarantees of promoter directors. In some cases, it has also been observed that some promoter directors leave their companies and resign from the board. Unfortunately, this only means one thing that such promoter directors do not have faith in themselves or on their own companies. The Companies Act should be amended to mention that wherever the company has accessed public money to run the production facilities etc. no promoter director will be permitted to resign from the board and try to withdraw from his personal guarantee till loan from the Banking system exist.

Enhanced Access and Service Excellence (EASE) programme for public-sector banks (PSBs) was launched by the Ministry of Finance for effective functioning of the PSBs. According to the scheme, the banks will be monitored and measured on their performance across six themes — customer responsiveness, responsible banking, credit off-take, financing and bill discounting for micro, small and medium enterprises (MSMEs), financial inclusion and digitalisation, and human resources development. Under the responsible banking pillar, banks are expected to tie-up with Agencies for Specialised Monitoring (ASMs) for clean and effective post-sanction follow-up in loans above ₹250 crores.

This article is obviously not exhaustive. All bankers worth their salt are expected to monitor the obvious and latent movements of various economic factors, especially overheating of certain sectors and limiting exposure if required, without any external prompting.

Jyoti Ghosh

Jyoti Ghosh started his banking career in the year 1978 and joined State Bank of Bikaner & Jaipur as a Probationary Officer. He has handled multifarious assignments during his long Banking career in India and abroad. During this vivid and diversified career of over 40 years, he worked in almost all the areas of activity of a Commercial Bank. He was instrumental in setting up the Loan Recovery Department at State Bank of Hyderabad as its first General Manager and later handled the corporate portfolio of the Bank as Chief General Manager. Owing to his vast and diversified exposure to different aspects of banking, he got selected for overseas assignment at State Bank of India's Frankfurt office for over 4 years. He was also Chief Dealer, Forex Treasury of State Bank of Bikaner & Jaipur.

He was also associated with Bandhan Bank as an Advisor to the Managing Director. He retired as the Managing Director of State Bank of Bikaner & Jaipur. He was also selected as one of the best CEO's by Business Today & PWC in 2016

We acknowledge his contribution and are thankful for the same.

Chapter 4

BENEFITS AND CHALLENGES

IBC is new —
and thus, will change
and evolve with time

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The Insolvency and Bankruptcy Code, 2016 (IBC) is a major reform in India. It represents a big change in the power equation between creditors and debtors. During the pre IBC days, lenders were at the mercy of big borrowers. The plethora of laws that were supposed to resolve stressed assets only resulted in interminable delays in courts. According to World Bank statistics, it took an average of five years to resolve a soured account.

The big change came with the code being enacted. The IBC mandates a timeline of 180-days, extendable up to 270 days, within which the resolution process has to be completed. The Code's focus on timelines and outcome neutrality are a fundamental shift from the thinking that prevailed in the pre-IBC regime. Laws like Sick Industrial Companies Act, or Companies Act only provided for one type of outcome and delays and pendency under both are well documented.

The new framework changes all that! It is a time bound process where cases once admitted are supposed to be resolved within a maximum of 270 days, failing which the debtor entity goes into liquidation. During the resolution process, management control is vested with the resolution professional.

IBC views both revival and liquidation as means of resolving a firm's stressed asset. It leaves the revival versus liquidation decision to the commercial judgement of the creditors of the company.

In fact, the whole debtor-creditor relationship has undergone a sea change, which is a big positive from the perspective of improving the credit culture of the country. This has led to better availability of credit and helped in improving the ease of doing business. Since the Code came into being, more than 2,434 cases have been filed before the National Company Law Tribunal. Out of these a large number of cases have wound up. When the Reserve Bank of India identified 12 large corporate borrower accounts in banks that accounted for more than a quarter of the gross non-performing assets, they were referred to the National Company Law Tribunal under the IBC.

> "The failure of some business plans is integral to the process of the market economy. When business failure takes place, the best outcome for society is to have a rapid renegotiation between the financiers, to finance the going concern using a new arrangement of liabilities and with a new management team. If this cannot be done, the best outcome for society is a rapid liquidation
>
> — Bankruptcy Law Reform Committee

However, the process of resolution through the Code has faced challenges in addressing a uniform method of resolution and in redressal of stressed assets.

The nature and area of business has been a deciding factor for the debtors to have optimal solutions to their unpaid debts and in identifying potential buyers. For instance, stressed assets in steel sector have generated noticeable interest through takeover bids and restructure proposals. The industry has had many prospective buyers expressing interest through takeovers due to the nature of the product and its demand outlook in the global and domestic markets. This sector also enjoys the government support through minimum import price and anti-dumping duty on certain category of products. Also as the economy stabilises and maintains a growth pattern, steel prices firm up.

It is precisely because of these reasons that the five large, distressed steel companies, who add up to about 20 per cent of domestic production capacity, make good candidates for acquisition by other large players interested in increasing their presence in the Indian market.

On the other hand, participation in the resolution process for companies in certain sectors was not much encouraging. There have been limited interests shown by the engineering, procurement and construction companies.

Motivating factors for lenders to use IBC

- Creditors have control as most decision making are vested with lenders
- Time bound and quick solution for stressed and NPA accounts
- Change of management possible
- Brings financial lenders to a platform — enabling quick decision making and arriving at consensus quickly
- Prepare and examine resolution plan by professionals appointed by creditors to ensure fearless decision making
- Final approval by NCLT (a legal entity) — so less stress/ fear of accountability/ vigilance
- Fair chance to viable and sustainable units for time bound revival
- In case of unviable accounts, faster, transparent and smooth liquidation process
- Clear and fair distribution of funds in case of liquidation. Government dues not to get priority
- Protection of assets of borrowers to maximise realisation

RECENT GOVT ORDINANCE AUTHORISES RBI TO FORCE BANKS TO USE IBC

The Reserve Bank of India points out that the power sector is a cause for concern in the absence of long-term power purchase agreements, lack of firm fuel supply agreements at a fixed price, cancelled allocated coal blocks, delays in payments by state distribution companies and non-remunerative tariffs. It is anticipated that a number of thermal power projects may get referred to the NCLT in the near future, especially after the notification of the revised framework for resolution of stressed assets by the apex bank in February 2018.

As per estimates, overall stressed thermal power generation assets in the private independent power producers segment at 60,000 MW are in severe state of malady.

Bidders' interests in thermal projects are expected to remain low because of greater haircuts to debt accounts.

Challenges in Insolvency and Bankrupcy Code, 2016

DILUTION OF RIGHTS OF SECURED CREDITORS

In so far as a constitution of creditors committee is concerned, the code does not distinguish between secured and unsecured creditors as voting rights depend on the amount owed to a creditor. Thus an unsecured financial creditor with the same exposure of a secured financial creditor will have similar voting rights in the committee of creditors. The position of the unsecured creditor to recover dues during liquidation is lower.

DISADVANTAGEOUS TO TRADE CREDITORS

Trade creditors receive their dues after unsecured financial creditors as per priority during liquidation. It is contented that financial creditors lend after risk assessment whereas the same opportunity may not be available to trade creditors. Thus trade creditors are at a disadvantage.

NEED FOR BETTER MONITORING OF IPs

IBBI need to ensure adequate monitoring of IPs to ensure transparency and avoid unethical practices. This would entail significant capacity building, both in terms of human resources and IT capabilities.

The interest in steel and the apparent discounts for power companies in resolution process do not create a single platform to have common judgements.

The other concern is whether the NCLT will have the capacity to cater to the growing number of cases coming up for resolution. As of now, the Ministry of Corporate Affairs has set up eleven benches — one principal bench at New Delhi and ten benches at New Delhi, Ahmedabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. The government is considering to increase the number of benches by two-folds to handle thousands of bankruptcy cases that are expected to come up.

It may be noted here, that given the present situation and infrastructure to help recover unpaid corporate loans, the NCLT has helped resolve insolvency and bankruptcy proceedings involving more than ₹80,000 crore during the previous year. This is expected to increase considerably in 2019 when several big-ticket defaulters get resolved.

It is now evident that the Insolvency and Bankruptcy Code is conceived with the right spirit and intent to seek resolution of distressed assets in a time-bound manner. Its effectiveness would remain greatly connected to the prevailing environment in the respective industries where bad loans need to be addressed.

The resolution process needs to be supported by time policy decisions to revive industries that have been suffering due to external factors. At the same time, it is imperative to minimise the legal tangles and plug the gaps in the interpretation of the law that can stretch the time taken to resolve bad loans.

The Insolvency and Bankruptcy Code is a new law and has been created in well crafted words to leave ambiguity to the least. Amendments will continue to follow as requirements to its interpretation grow. Since its birth in December 2016, it has been fine tuned through amendments to clarify ambiguities and address difficulties.

Exciting Times Ahead

Engineering Consultants are evolving to accelerate resolution process under the IBC

Abhijit Sarkar

Vice President,
M N Dastur

Introduction

With the introduction of the Insolvency and Bankruptcy Code (IBC) in December 2016, a sea change in the resolution of stressed assets in India has come about. This article examines the backdrop that necessitated the IBC, reviews some of the changes implemented in the first two years of the IBC's existence, and the role of Engineering Conultants in accelerating these changes.

Macro Background And The Pre IBC Era

A key factor that has hindered faster infrastructure growth in India is the development of functional credit markets to lower the cost of capital and ease the capital investment mechanism. In the World Bank's 2019 Doing Business (DB) report, which is widely considered an economic barometer for guiding domestic and foreign capital investment, India makes it to the ranks of the most improved counties, but resolving insolvency is still an area where India trails behind (Figure 1). In spite of overall improvements, India still ranked #77 out of 180 countries in 2019, but up from a shocking #142 in 2015. The lack of efficient processes for resolving insolvency, i.e., the recourse for banks and other lenders for when borrowers run afoul of their commitments, continues to be a key factor hindering India's economic advancement.

TABLE 1.3 The 10 economies improving the most across three or more areas measured by *Doing Business* in 2017/18

Economy	Ease of doing business rank	Change in ease of doing business score	Reforms making it easier to do business									
			Starting a business	Dealing with construction permits	Getting electricity	Registering property	Getting credit	Protecting minority investors	Paying taxes	Trading across borders	Enforcing contracts	Resolving insolvency
Afghanistan	167	+10.64	✔				✔	✔	✔			✔
Djibouti	99	+8.87	✔			✔	✔	✔			✔	✔
China	46	+8.64	✔	✔	✔	✔		✔	✔	✔		
Azerbaijan	25	+7.10		✔	✔	✔	✔	✔	✔	✔		✔
India	77	+6.63	✔	✔	✔		✔		✔	✔		
Togo	137	+6.32	✔	✔	✔	✔			✔		✔	
Kenya	61	+5.25				✔	✔	✔	✔			✔
Côte d'Ivoire	122	+4.94	✔	✔			✔		✔		✔	
Turkey	43	+4.34	✔	✔			✔		✔	✔	✔	✔
Rwanda	29	+4.15	✔		✔	✔	✔			✔	✔	✔

Still missing

Figure 1: List of most improved counties in Word Bank's 2019 Doing Business Report

Despite of making substantial strides through the introduction of the Insolvency and Bankruptcy Code (IBC) in December 2016 and the creation of the National Company Law Tribunal (NCLT), India’s scores in this department remain lower than many developing peers. For example, Indian cities of Delhi and Mumbai score ~40 versus China’s score of 55 and Mexico at 70.

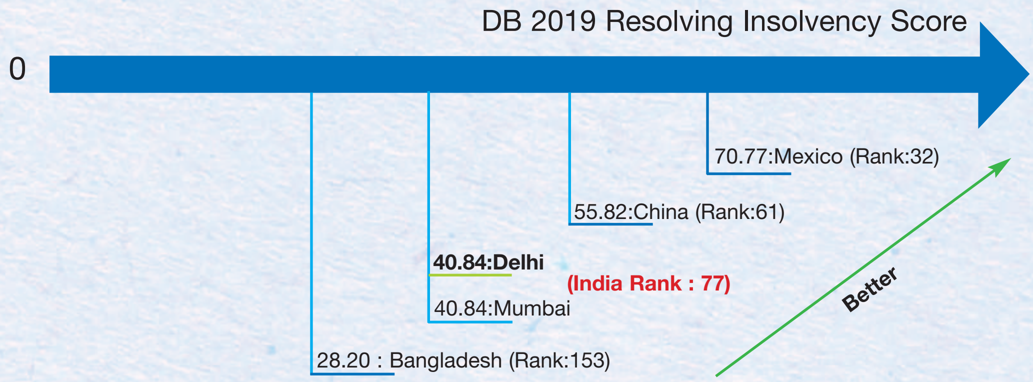

Figure 2: Source: India Resolving Insolvency Score, DB Report 2019

In the pre IBC era in India, lenders, who extended the bulk of the capital for power, infrastructure, steel and other capital intensive industries, remained at the mercy of borrowers when it came to getting back their interest and repayment. The unique challenges of infrastructure assets — securing necessary licenses and permits, managing difficult labour conditions, ensuring steady supply of raw materials, as well as poor legislative and courts infrastructure that made a quick resolution unlikely, ensured that change of control remained a daunting step for any banker to initiate. This resulted in a classic "moral hazard" that transferred tremendous power to defaulting borrowers. Combined with lax lending practices at banks that encouraged credit growth for this sector, promoters could borrow without having to pay the penalties of being wrong if they were unable to repay per schedule. The absence of a definitive process to transfer control from defaulting promoters into new management sealed the fate of any transitions that were attempted. Prior to the IBC, Indian insolvencies recovered 26 per cent of assets and on average took 4.3 years to do it versus developed country averages of 70 per cent and 1.7 years.

Indicator	Delhi	South Asia	OECD high income	Best Regulatory Performance i
Recovery rate (cents on the dollar) i	26.5	32.7	70.5	None in 2017/18
Time (years) i	4.3	2.6	1.7	0.4 (Ireland)
Cost (% of estate) i	9.0	9.9	9.3	1.0 (Norway)
Outcome (0 as piecemeal sale and 1 as going concern) i	0	–	–	–
Strength of insolvency framework index (0-15) i	8.5	6.6	11.9	None in 2017/18

Figure 3: India's recovery rate and time to resolve tracked developed world peers, as expected, DB Report 2019

IBC Introduction And The Report Card So Far

Since the IBC came into force in the fourth quarter of 2016, significant strides have been made, but results have been a mixed bag. Control of the stressed entities passes almost immediately into the hands of a resolution professional once an entity is accepted by the NCLT for resolution. The prospect of continuing to hold on to assets or secure additional loans from lenders while defaulting, has shrunk to zero, due to a time bound resolution process laid out by the IBC. This has already had the desired effect of removing the moral hazard and improving ex-ante behaviour of the borrowers, versus the prior regime, where there was no real consequence to non-payment.

The haircuts for the first set of 12 large accounts referred by the RBI to NCLT have been substantial, ₹55000 crore at an average haircut of 47 per cent. Still, this is much higher than the 26 per cent estimated by the DB report prior to the implementation of the IBC mentioned above, not to mention the accelerated manner of the resolutions, since the IBC mandates resolution of insolvency proceedings within 180 days. The 180 days can be extended by a maximum of another 90 days. In the absence of this, the NCLT is bound to initiate liquidation proceedings to recover whatever is possible from the market.

The Indian Ministry of Corporate Affairs (MCA) estimates that since it came into existence, the IBC has helped address a total of ₹3 lakh cr worth of stressed assets, inside and outside the NCLT process, i.e.by resolution before being admitted to NCLT. In 2018 alone, almost ₹80000 cr worth of assets changed ownership including high profile Bhushan Steel taken over by Tata Steel, Electrosteel taken over by Vedanta Group, and Binani Cement which was taken over by the Ultratech Cements. In 2019, a number of high profile stressed assets await resolution including Bhushan Power and Steel with ₹45000 cr of debt and Essar Steel with ₹80000 cr of debt.

The Role Of Engineering Consultants In The IBC Process

Since the NCLT process started, engineering consultants have played a key role in accelerating the process and assisting lenders, investors and resolution professionals in the recovery and transfer of ownership. At the very beginning (Figure 4), bankers and lending consortia require an independent assessment of the profitability of stressed assets to determine what constitute reasonable recoveries through an unbiased techno-economic evaluation, and use that information in convincing investors. Often the current operating results of a stressed entity may deviate significantly from what should be business as usual results, due to working capital shortages or leakages. Assessing and correcting for that requires an independent construction of pro forma financials from a consultant with sufficient techno economic understanding of the industry to project profitability.

Pre NCLT Phase	NCLT Phase	Post Acquisition
• Technoeconomic assessments for lenders • Recovery Projections • Operations Improvement proposals	• Interim Operations (60 90 120 day plans) • Operations and cash flow monitoring • Valuation and bid preparation • Synergy estimates	• Hidden capacity and expansion alternatives • Asset Valuation • Operational Management Assistance • Financing

Figure 4: Engineering Consultants in different phases of NCLT process

Once an entity enters the NCLT process and a Resolution Professional is assigned, consultants can assist with various operational tasks to ensure operations and profitability continue unabated. At the same time investors and other interested parties reach out to knowledgeable consultants to evaluate individual assets or ask for NCLT or pre NCLT assets that match specific investment parameters and investment styles. While for some investors finding the cheapest investment in terms of multiples of operating metrics (earnings or EBITDA) or discount to replacement value is the key criteria, for others the quality of the business reflected in a differentiated product set and a secure raw material supply chain may be preferred, even at a premium valuation.

Finally, once the Committee of Creditors (CoC), the representative of the lenders, decides on the new owner, one enters the Post Acquisition phase and there is an entirely new set of activities for the new owner, in terms of creating an asset register of facilities, go forward plans and securing operating and expansion financing from banks that take centerstage. These require engineering consultants who are either familiar with the stressed asset a priori, or are knowledgeable enough to carry out such an exercise in a predictable, efficient and reliable manner.

A separate graphic showing the different services by audience- lenders, investors, resolution professionals, is shown below in Figure 5.

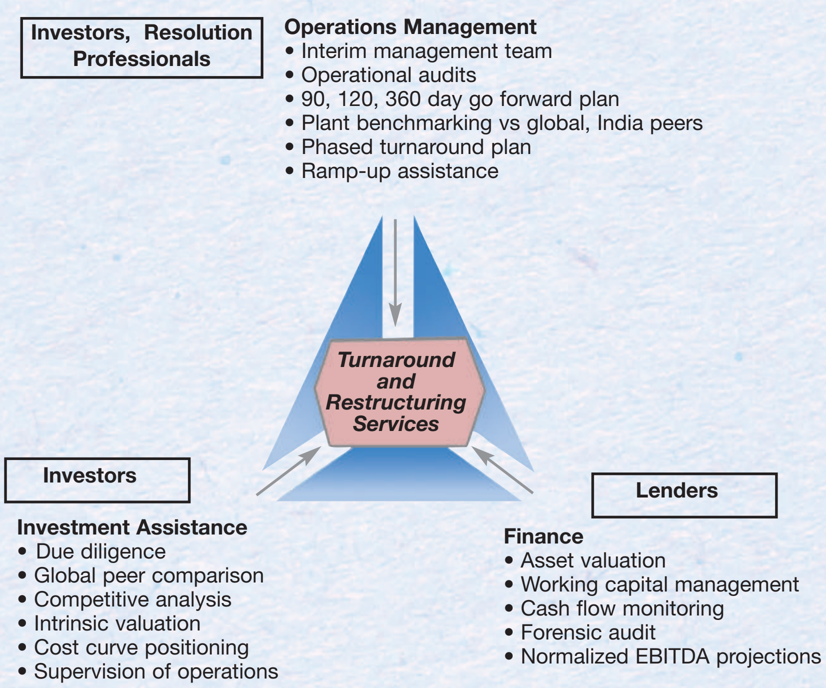

Figure 5: Types of services by audience, lenders, investors and resolution professionals

The Rationale For Engineering Consultants

With proprietary data banks and experiences from a wide range of assignments, engineering consultants carry out benchmarking and improvement projects without getting fazed by the operational complexity of the asset. Onsite experts require SMEs (subject matter experts) with experience in relevant areas. For example in the steel company one may need coal gasification, sintering, coke-making, Dry Reduced Iron, Basic Oxygen Furnace or Electric Arc Furnace experts as the case may be. Examination of supply chains and opportunities to reduce raw material costs, which make up 60 per cent + of revenues in steel and power industries are key requirements as well. An example of the different types of expertise that may be required are demonstrated in Figure 6.

Product Mix	Raw Materials	Operations	Capacity	Energy
Product Mix Rationalisation	Scouting Organisation	Cycle Time Reduction	Utilisation Studies	Energy Audits
Direct Cost Reduction	Feedback substitution	Bottleneck Analysis	Hidden Capacity Extraction	Technology Evaluations
Channel Improvement	Supply Chain Re-design	Logistics Re-sequencing	Capacity Consolidation	Intensity Benchmarking
Pricing Re-design	Direct Cost Reducation	Quality Control	Capacity Re-sequencing	Energy Reduction Strategies
Post Merger Consolidation	Contract Re-engineering	Operations Benchmarking	Vertical Integration	Energy Substitutions

Figure 6: Wide range of expertise needed in assessment of intrinsic value

The views of these different operating experts are brought into a common framework for comparison and action. Improvement initiatives are bucketed by capex and low/ no capex, and stack-ranked in terms of return on investment. Projects from this list are then undertaken in bite size chunks for implementation on a quarterly basis.

Being aware of the intrinsic quality of the equipment at different facilities as well as other hidden advantages such as low capex initiatives to increase profitability through product mix upgrades, engineering consultants are in an advantageous position to steer new investors towards distressed assets of higher quality- as the search for quality in distress is often equated to looking for a needle in a haystack (Figure 7).

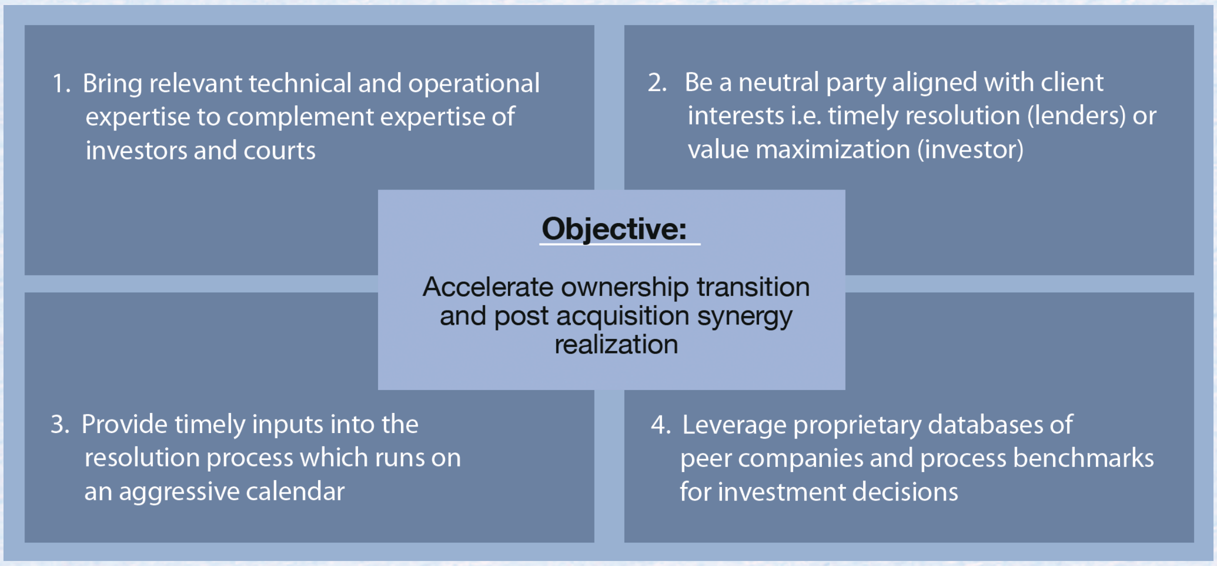

Figure 7: Engineering Consultants bring a range of experiences and tools to the NCLT process

Summary

In summary, this is an exciting time for the establishment of a functional bankruptcy regime in India and more importantly, in restoration of capital and operating efficiency and accountability in the infrastructure, power and other capital-intensive sectors in India. Years hence, I hope we look back at this period as the messy and tumultuous time when the first steps were taken to overturn the dysfunction of past insolvency resolution, and when we paved the way for efficient corporate debt markets that form the basis for modern infrastructure in a developed India.

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He is the vice president of Dastur and heads the M N Dastur & Co (P) Ltd. strategy, restructuring and advisory business. He has also been an investor and advisor to firms in areas of finance, business and technology in North America and India. This includes being an advisor to one of the leading technology firms in the world in a consulting capacity, a significant foreign institutional investor into India investing hundreds of millions of dollars into the Indian steel and other sectors at Janus Capital, heading business development and product planning at Microsoft Corporation and also leading Product Management at Cambridge MA, based software company called CenterLine Software.

We acknowledge his contribution and are thankful for the same.

Key issues in Cross Border Insolvency

Ran Chakrabarti

Lawyer

Introduction

Picture the scene: a major private Indian airline, Woodpecker Airways is struggling with its cash flow. Its creditors have lent it substantial amounts of money for fleet acquisition and increased competition in the aviation market has seen its market share drop substantially. Cash flows are dropping, but operational costs and financing costs for the recent fleet acquisition of brand new Boeing 787 Dreamliners are rising.

It has been months since the staff was last paid and pilots are threating to go on strike. Operational creditors have been asked to remain patient with promises that their dues will be settled, but the catering and baggage handling costs remain unpaid, with default interest racking up on late payments.

Scheduled repayments of interest on debt haven't been paid and the creditors are demanding their dues. Woodpecker's besieged CEO is struggling to refinance the existing debt and secretly, he doesn't know how the airline will make it through the next month.

A meeting of Woodpecker's financial creditors looks ominous. With their loans non-performing, it's only a matter of time before one of them calls an event of default, triggering a cross default across all of its financing arrangements and major commercial contracts. Creditors anxiously assess whether they are secured; and if so, ponder what assets are secured and where they might be?

The sound of the ruffling of paper echoes around multiple financial districts across the globe as legal counsels in shiny glass plated offices assess whether their client's loans are guaranteed and if so, by who; and whether their last set of audited financials demonstrate that they will be good for the money.

And then, the inevitable happens. The airline goes bust. Flights are cancelled, planes are grounded; many at foreign airports and passengers are stranded.

It's not too difficult to see how this fictional set of circumstances can materialise for any business and the how and the why businesses fail in ever increasingly competitive markets, inevitably boils down to a squeezing of cash flow. Those rosy projections of revenue in the business model and the excel sheets just didn't work out as planned; and the operational and financing costs turned out to be more extensive than first thought.

Effective insolvency law is designed to deal with these types of events. While it might be catastrophic for the individual business, from a public policy perspective, the key thing is the efficient and timely recycling of capital, unlocking value for distribution amongst the businesses' creditors.

Historically, insolvency law was very much intra-jurisdiction focused, drafted at a time when most businesses and commercial transactions, operated within their own borders. Globalization and increased cross-border trade has changed the fabric of business, with most business relationships having multiple links crossing borders and it is in this context that the implications of insolvency need to be put to the test, giving those affected, effective and timely legal recourse in a stream-lined and logical process.

So how are cross-border insolvency issues dealt with in the context of Indian businesses? To understand the complexities involved, we first need to understand the role of the Indian entity in the unfolding insolvency. Is it the insolvent entity itself, with assets and creditors located in multiple jurisdictions? Or is it a creditor to a foreign business with assets located in multiple jurisdictions and potentially in India? If it is a creditor, is it a financial creditor or is it an operational creditor, owed money for goods or services provided? An understanding of the problem is critical in assessing the options available and the chance of recovering money owed.

Until recently, cross border insolvency had no clear legal framework in India and The Ministry of Corporate Affairs, on June 20, 2018 issued a public notice (the "Notification") inviting comments and suggestions on the draft chapter on cross border insolvency it plans to introduce under the Insolvency & Bankruptcy Code, 2016 (the "Code"), based on the United Nations Commission on International Trade Law Model Law on Cross Border Insolvency (the "UNCITRAL Model Law").[2]
In the light of these recent developments, this paper seeks to address the basic principles of cross-border insolvency and map out what might happen when an Indian insolvent entity has substantial assets overseas.

Cross Border Insolvency Scenarios

Insolvency is essentially the inability to pay a debt owed. In case of a corporate entity having transnational operations, insolvency type scenarios might be triggered by a number of circumstances, and in particular, in the Indian context:

- Where an Indian entity has domestic and foreign creditors, holding assets in India and overseas;
- Where an Indian entity has foreign subsidiaries, and guarantees the financial debt of its overseas subsidiaries (and potentially has granted security over its shares to foreign creditors); and
- Where a foreign entity has foreign creditors, holding assets across a number of jurisdictions, including India.

The issues stemming out of these scenarios are complex.
In particular, where a parent company guarantees the debt of a number of overseas subsidiaries or other group companies, it creates contingent liabilities to discharge, in the event that one of its subsidiaries or group companies cannot discharge their

financial obligations. If a number of its subsidiaries or group entities fail, then the call on the contingent liability created under the guarantees may be so large, that the parent guarantor can no longer meet its obligations.

In the context of our fictional scenario described in the introduction to this paper, in the event that Woodpecker Airways can no longer meet its financial obligations owed to creditors, then, an event of default called by a particular creditor under one loan agreement, will, more than likely, cross default other loan agreements with other lenders (and other key operational contracts with suppliers).

Should any financial creditor (or an operational creditor) file for insolvency, then, if admissible, under the Code, it will essentially create a moratorium on all claims for debt against the insolvent entity (whether already existing or yet to be filed), so that the process for administering the claims of various interested parties is rationalised and converged.

Let's say, for example, that one of Woodpecker Airways' financial creditors files an application for insolvency against the airline. Under the Code, and during the moratorium period, the insolvency resolution professional will essentially have to figure out who have a valid claim against the airline, what the airlines' assets are and also, where they are. If there are planes on the tarmac of foreign airports, then this might pose a bit of a jurisdictional problem in ascertaining control over them for the benefit of the airline's creditors.

But will foreign courts acknowledge and assist insolvency proceedings brought under the Code in India and will that take precedence over contracts between foreign creditors and the Indian entity governed by foreign law? What will happen if, say, foreign lenders, providing financing for Woodpecker's aircraft under English law financing documents commence parallel proceedings to enforce their security over the aircraft before the English courts?

Intuition might suggest two things: firstly, that a foreign court should grant the insolvency resolution professional appointed under the Code in India, assistance in any application to prevent the sale of assets located in that foreign jurisdiction, belonging to the Indian entity; and secondly, stay proceedings brought by foreign creditors in their courts for amounts due under foreign law contracts, which should, theoretically, be subject to the moratorium period under the Code.

Before we examine whether our intuition is correct, we should point out that India has not yet adopted the UNICITRAL Model Law and Section 234 of the Code, simply grants the Indian government with the flexibility to enter into agreements with other countries (and presumably, multi-lateral treaties) in the context of applying the Code to assets located outside of India (and likewise, afford recognition and grant rights to foreign representatives managing foreign insolvency proceedings before the Indian courts).

The Theory

Cross border insolvency, in essence, can be distilled down to three key questions: which law should be applied; who has jurisdiction to administer the insolvency process; and how are judgments asserting control over assets enforced?
The treatment of financially distressed debtors, with assets across jurisdictions has two main theoretical approaches, and a third, more practical model. Firstly, there is the territorial approach, which broadly sets out that each jurisdiction applies its own laws over assets located in that jurisdiction, to the exclusion of other jurisdictions. Secondly, there is the universalist approach, with a single administrator applying a single global regime over assets, across borders. Thirdly, there is the hybrid approach, where jurisdictions try and work out the most relevant center for conducting the proceedings, with co-operation from other jurisdictions in relation to assets that may be located there.

Cross border insolvency has a long history before common law courts. In Solomons v Ross[3] a Dutch trading firm was declared bankrupt and an English creditor brought proceedings before the English court to attach certain sums owing to the Dutch firm. The court held that the bankruptcy proceedings had vested all the assets of the Dutch firm (including monies owed to it by English debtors) in the Dutch assignees and the English creditor had to surrender its attachment and prove it before the Dutch courts. Further, in Galbraith v Grimshaw[4] an English court held that there should be only one universal process for the distribution of a bankrupt's property, and where that process was pending elsewhere, the English courts should not let actions within its jurisdiction interfere with that process.

The UNCITRAL Model Law

The UNCITRAL Model Law attempts to deal with the complexities outlined above through rationalising the process in dealing with cross-border insolvency, but it should not be mistaken for creating a substantive, unified insolvency law.
It does this by providing a framework for access to insolvency appointed professionals in the courts of other jurisdictions, permitting them to participate or commence proceedings in that particular jurisdiction, though in the Indian context, this may need to be modified, on the basis of locus standi in the Indian courts, requiring foreign insolvency professionals to appoint an Indian insolvency professional to represent them in Indian proceedings.

It also lays out principles for where insolvency proceedings should be initiated. The UNCITRAL Model Law sets out a principle for identifying the most appropriate jurisdiction for commencing insolvency proceedings (the main proceeding) and ensures that the resolution professionals appointed in that jurisdiction are granted recognition and access in proceedings in other jurisdictions, where the insolvent entity may have assets (the non-main proceeding).

In essence, the UNCITRAL Model Law sets out the principle of center of main interests (commonly referred to as "COMI") in deciding where the main proceeding should be commenced. Interestingly, COMI is not given a definition in the UNICTRAL Model Law. It broadly implies that it is the seat of a corporate entity's major stakes, whether that is in terms of control or the location of its assets and its significant operations. COMI is determined by factors, both objective and ascertainable by third parties, especially creditors and potential creditors.[5]

Essentially, the command and control test is the commonly applied test to determine the COMI of an entity.[6] There is a presumption in favour of the place of its registered office, which normally corresponds to the head office of the company[7] and this presumption has worked well where there is no serious controversy.[8] In effect, the registered office, or the place of incorporation serves as proof of existence of a corporate entity.

The registered office, however, does not otherwise have special evidentiary value and does not shift the burden of proof away from the foreign representatives seeking recognition as a main proceeding.[9] Courts generally take into account other factors, such as the location of the debtor's headquarters; the location of those who actually manage the debtor (which could possibly be the headquarters of a holding company); the location of the debtor's primary assets; the location of the majority of the debtor's creditors or of a majority of the creditors who would be affected by the case; and the jurisdiction whose law would apply to most disputes.[10]

In order to rebut the presumption of the COMI under Article 16 of the UNCITRAL Model Law, one would be required to prove the involvement of agents or servants acting for the company go beyond commercial activities, and the sorts of functions that one would expect the head office to discharge.[11]

In not so obvious cases, the courts have held that the COMI would be situated where inquiries and negotiations involving third parties were dealt with and upon where demands for payment and invoices from third parties would be addressed.[12]

In the Indian context, the initiation of proceedings against an Indian corporate entity when the COMI lies in India itself makes such proceedings the "foreign main proceedings"[13] (under the UNCITRAL Model Law) for a foreign creditor. This implies that the provisions of the Code would take immediate effect. Recognition of the proceedings as a main proceeding will result in automatic relief such as a stay or moratorium on domestic proceedings in relation to the debtor, and the Indian insolvency professional would, presumably be afforded rights as a foreign representative of a foreign main proceeding before the courts of contracting states to the UNCITRAL Model Law, in any application to stay parallel main proceedings, or otherwise, to commence secondary proceedings in relation to the Indian debtor's assets which may be located overseas.

As discussed, however, in the case of the COMI of an Indian debtor falling outside India, foreign main proceedings shall ensue in that jurisdiction, and the Code, having no extra-territorial effect as of now, shall cease to apply. In such circumstances, relief available to Indian creditors in that jurisdiction is subject to the laws of where the foreign main proceedings are initiated and the provision of the Code, shall be applicable, only in so far as it is consistent with or otherwise, at the discretion of the court in who's jurisdiction the foreign main proceedings are commenced.

It should be stressed that the UNCITRAL Model Law does not import the substantive law of the foreign system into the insolvency system of the enacting state, nor does it apply the relief that would be available under the enacting state in any foreign proceedings. It does however, grant recognition and assistance to foreign representatives of an insolvency resolution process in applying for interim relief and automatic stays, where available in that particular jurisdiction where such relief is sought.

The Current Legal Framework In India

Sections 234 and 235 of the Code deal with cross border insolvency in a cursory manner, empowering the government to make treaties and further empowering the Adjudicating Authority under the Code, to issue a letter of request to a court in a country, with which an agreement has been entered into, to deal with the assets in a specified manner (presumably, in accordance with the provisions of the Code). Theoretically, this should also provide a framework for foreign representatives to apply to the Indian courts to deal with assets in India in a manner consistent with the insolvency laws of the jurisdiction where foreign main proceedings have been initiated, in relation to a debtor, with assets in India.

For foreign proceedings to be recognised in India, the process set out under the Civil Procedure Code, 1908 will be applicable, together with English common law principles, though it should be noted that it is not broad enough to cover some insolvency related proceedings. Likewise, for Indian proceedings to be recognised abroad, the procedural rules of that foreign jurisdiction will apply. Those countries that have adopted the UNCITRAL Model Law (which include most industrialised countries) are required to provide recognition, assistance, cooperation and appropriate relief in relation to insolvency proceedings commenced in India, except where that country has otherwise required reciprocity.

As of June 2018, 44 states have adopted the UNCITRAL Model Law, including the United States, the United Kingdom and Singapore. Note, however, that certain countries that have adopted it may have made reservations to it, and may require reciprocity.[14]
Clearly, while the Code permits the government to enter into treaties to implement the UNCITRAL Model Law, negotiating up to 200 separate bilateral treaties in a relatively short space of time is just not practical, and it would further complicate matters, with the Indian courts having to take into account the nuances of each treaty in any cross border insolvency matter. Surely, the simplest solution would be for India to simply sign and ratify the UNCITRAL Model Law and then incorporate that into the Code.

What Happens Where An Insolvent Entity Has Substantial Assets Overseas

Insolvent entities (or those which are being restructured) might have substantial assets outside of its COMI, which may be directly held (for example, the entity itself might be the legal registered owner of property, or in the case of Woodpecker Airways, aircraft parked at the gates of foreign airports).

It may also have shares in foreign subsidiaries or other group companies, and these share certificates, are essentially moveable property (though they are likely to be pledged to any lender of the subsidiary or the group company as security for any loan).

However, it needs to be underlined, that the assets of any foreign subsidiary or group company are not the assets of the insolvent parent company (other than the shares held by it in any such foreign subsidiary or group company). This is a cardinal principle of limited liability and the courts will only lift the veil on the ring fencing of liabilities in exceptional circumstances.

Broadly, there are three situations where an Indian company might be impacted in a cross border insolvency scenario;[15]

- firstly, when a foreign creditor wishes to initiate or be a part of any insolvency proceedings against an Indian company, initiated under the Code, in India;

- secondly, where the creditors of an Indian company wish to enforce rights over the assets of the Indian company which are located overseas; and
- thirdly, when insolvency proceedings are initiated against a debtor in more than one jurisdiction (and that debtor has assets in India).

In the first circumstance, under the provisions of the Code, foreign creditors may already apply to the Adjudicating Authority for either the initiation of insolvency proceedings against the Indian entity or to be a part of the ongoing proceedings, in the same manner as domestic creditors, with the same rights. The Code, by virtue of including a “person resident outside India” in the definition of “persons”,[16] rightly underlines the principle of neutrality towards the identity of creditors.

However, the Code had fallen short in addressing the other two situations, wherein there is neither a provision for automatic attachment over assets situated overseas nor for parallel simultaneous proceedings against the corporate debtor in more than one jurisdiction.

In non UNCITRAL Model Law contracting states, the principles of private international law essentially govern cross-border insolvency, and a formal application will need to be made to attach those assets in the court of the relevant foreign jurisdiction where the corporate debtor may have assets.

In UNCITRAL Model Law contracting states (and those contracting states that accept applications from insolvency professionals in non-contracting states), generally, co-operation, assistance and recognition of foreign law proceedings will be afforded. It's perhaps pertinent to now turn to the question of how other jurisdictions approach the problem of locus standi in the context of foreign insolvency proceedings and orders from foreign courts or tribunals?

The United Kingdom, for example, although it does not recognise India as a "relevant country" under the provisions of Section 426 of the Insolvency Act of 1986[17], it does, however, provide an insolvency professional the right to approach the English Courts to either request recognition of insolvency proceedings under which it has been appointed, so as to ensure that assets located in the UK become part of the Indian insolvency proceedings, or, otherwise, be a part of insolvency proceedings initiated by a creditor in the UK.

But what about contracts between an Indian insolvent entity and foreign creditors, which are governed by English law? Will those foreign creditors be subject to (and bound by) the Code in the event that an insolvency resolution process is triggered in India against an Indian debtor? Will those foreign creditors need to prove their debts through the process in India and does the moratorium under the Code apply to parallel proceedings by foreign creditors before foreign courts, seeking enforcement of any local security interests?

There is a long-standing principle of English law that a debt governed by English law cannot be discharged by a foreign insolvency proceeding, unless that creditor submits to those foreign proceedings, derived from the decision by the English Court of Appeal in Anthony Gibbs and sons v La Société Industrielle et Commerciale des Métaux.[18] The so called Gibbs Rule was recently put to test by English courts in the case of the Bakhshiyeva v Sberbank of Russia & Ors [2018] EWHC 59 (Ch). In this case, the court considered an application by a foreign representative to the English court on behalf of the International Bank of Azerbaijan (the "Debtor") for a permanent stay on a creditors' enforcement of claims in England under English law contracts, contrary to the foreign insolvency proceeding, to which the creditors of the Debtor were purportedly bound.

In this case, the foreign insolvency proceedings had been initiated in Azerbaijan against the Debtor and a restructuring plan had been agreed by nearly all of its creditors (the "Restructuring Plan"), which had been approved by the Azeri courts (the "Approving Order") and the question arose as whether they should be recognised in England under the Cross Border Insolvency Regulations, 2006 (the "CBIR", which broadly, implement the UNCITRAL Model Law).

The judgment is quite an interesting one, because there are essentially three issues at stake: firstly, whether a moratorium can be extended indefinitely (when it appears that the moratorium period under local law seems to be on the brink of expiry); secondly, whether creditors with rights under foreign law documents, who did not participate or agree to the restructuring plan are bound by it; and thirdly, whether the Gibbs Rule is still good law.

Turning to the brief facts of the case, Sberbank had lent USD 20 million to the Debtor, pursuant to English law financing documents. Another creditor, Frankin Templeton, was the beneficial owner of USD 500 million of notes, issued by the Debtor, also governed by English law (Sberbank and Frankin Templeton together, being the "Respondents").

The Respondents did not participate in the Restructuring Plan and did not consent to it. At first instance, the English court granted the representative of the Debtor the relief sought, imposing a moratorium, preventing creditors in general, and the Respondents in particular, from commencing or continuing any action against the Debtor.

The Respondents appealed the decision, arguing that the foreign restructuring proceedings under Azeri law came to an end at the end of January 2018 and further, it did not bind them, relying on the Gibbs Rule.

It was cited in the judgment that many English law insolvency academics now consider the Gibbs Rule as an anachornism, with some going so far as to say that the "Gibbs doctrine belongs to an age of Anglocentric reasoning which should be confined to history."[19] It was also pointed out in the proceedings that in the case of Pacific Andes Resource Development Ltd, the Singapore High Court[20] chose not to be bound by the Gibbs Rule, finding that:

"In the case of a contractual obligation which happens to be governed by English law, a further rule should be developed whereby, if one of the parties to the contract is the subject of insolvency proceedings in a jurisdiction with which he has an established connection based on residence or ties of business, it should be recognised that the possibility of such proceedings must enter into the parties' reasonable expectations in entering their relationship, and as such may furnish a ground for the discharge to take effect under the applicable law."

The Gibbs Rule is not doubt problematic: on the one hand, it does not recognise foreign insolvency or restructuring proceedings taking precedence over an English law debt; yet on the other hand, the English courts generally expect a foreign court to recognise its own judgements in relation to a restructuring in England, over and above foreign creditor's rights under a foreign law loan agreement. This appears to be a paradox.

On the question whether the Gibbs Rule had been eroded by the adoption of the UNCITRAL Model Law (incorporated under the CBIR), some academics have pointed out that:

"In situations where a restructuring is on foot in the foreign jurisdiction, the foreign representative can seek recognition in England pursuant to Article 15 of the [Model Law]. (One is obviously dealing with a situation where the foreign representative does not wish to proceed with a parallel scheme of arrangement in England and creditors have not sought to invoke the English court's insolvency jurisdiction.) Provided the foreign representative was appointed in foreign main proceedings, i.e. where the debtor has the centre of its main interests, the mandatory consequences of recognition include, under Article 20(1), the staying of both creditor actions and executions against the debtor's assets …"

Furthermore, the effect of this for foreign creditors who do not agree to any restructuring plan initiated in the debtor's COMI should become obvious:

"Hence the foreign representative can stymie a hold-out creditor who might be minded to ignore the foreign restructuring and proceed instead to bring an action or to seek to execute in England, relying upon a debt that arose under an English contract. By applying for a stay the foreign representative may not have to deal, at least not immediately, with the substantive question of whether the English debt will ultimately be discharged by the foreign proceedings.

However, the application of Article 20 in respect of a foreign restructuring is not wholly free from complexity. The reference in Article 20(2)(a) to 'as if' a winding-up order had been made raises some uncertainty. For there is, of course, no discharge in a winding up.

Thus one may ask: what will happen in England in respect of the stay once the foreign restructuring plan has been approved, the corporation resumes trading outside bankruptcy protection and the foreign proceedings are formally closed by the foreign court?"

Nevertheless, pursuant to the definitions of a foreign proceeding[21] and a foreign representative[22] under Article 17(1) of Schedule 1 to the CBIR, the court must recognise a foreign insolvency proceeding if:

- The foreign insolvency proceeding constitutes a "foreign proceeding" as defined by Article 2(i) of Schedule 1 to the CBIR;
- The applicant is a "foreign representative" within Article 2(j) of Schedule 1 to the CBIR; and
- The application satisfies the evidential requirements set out in Article 15 of Schedule 1 to the CBIR.

Where a foreign liquidation is recognised by the English court as a foreign main proceeding, under the CBIR, then the debtor benefits from an automatic stay in England.[23] However, the situation is slightly different in the context of a foreign restructuring where an administration moratorium is granted.

In considering a similar case, based on similar facts to the Sberbank case, the English court, in Re BTA Bank JSC [2012],[24] granted a stay order for two principle reasons: "first, the relief is appropriate because it enables the English court to cooperate with the financial court in Almaty City in subjecting the bank's assets and claims to a single regime for the benefit of the general body of claimants. Secondly, I consider the relief appropriate because there plainly should not be an unseemly scramble for English assets by English claimants to the possible prejudice of the general body of claimants, but there should be an ordered approach to such English claims as might survive the Kazakh insolvency process."[25]

Notwithstanding the decision in Re BTA Bank JSC, the court held that the UNCITRAL Model Law and the CBIR does not empower an English court to vary, or discharge rights granted under English law, or otherwise, essentially conform the rights of creditors under English law, with the rights that they have under foreign law (and have otherwise, not consented to).

What appears to be a critical empahsis in the judgment is the distinction between insolvency (and the distribution of assets) and restructuring (and the variation or removal of rights). Although they are both collective proceedings (involving the debtor's creditors), the first process relates to the removal of assets from the grasp of a single (or class of) creditor in a particular jurisdiction (for the collective benefit of the creditors as a whole), while the second process relates to the denial of contractual rights, if that creditor has not consented to a restructuring plan.

The Sberbank judgment further seems to underline that the English courts will not apply foreign law, or apply English law in such a manner that replicates or achieves the intended relief that may be available under foreign law, if such a result could not be achieved under English law.

So to what extent does the Code and the proposed incorporation of the UNCITRAL Model Law address the lacuna of the Gibbs Rule and what, in the context of the Sberbank judgment, might happen if an Indian debtor undergoing the corporate insolvency resolution process in India under the Code had foreign creditors pursuant to English law financing documents?

In these circumstances, would an English court admit the insolvency resolution professional's application as a foreign representative to stay any action by those creditors until the moratorium period had expired under the Code? Can it already do this by virtue of the CBIR incorporating the UNCITRAL Model Law, without further legislative action required in India, adopting the UNCITRAL Model Law as part of the Code?

In the absence of any reservation made by the United Kingdom in relation to reciprocity for its insolvency representatives in India, granting it rights under the UNCITRAL Model Law, it is reasonable to conclude that the answer to that question would be yes.

Secondly, would the English court reject any application for a permanent stay or moratorium made by the Indian foreign representative in connection with foreign creditor's rights under English law financing documents and the Indian debtor's assets located in the United Kingdom?

What can we take away from the Sberbank judgement is that an application for permanent relief that goes beyond the moratorium period of the restructuring process in India, will likely be struck out by an English court. But that's a different conclusion from temporary relief, preventing creditors from asserting their rights under English law documents against the Indian debtor in the UK during the moratorium period under the Code in India; and such temporary relief is likely to be granted by an English court.

The Code enables the Adjudicating Authority to send a Letter of Request to an appropriate Court of the country with which a bilateral treaty has been entered into under Section 234, for recognition of proceedings, though theoretically, such a request is still subject to the discretion of the English court and the application of the Gibbs Rule, notwithstanding the provisions of the UNCITRAL Model Law and the incorporation of it under English law through the CBIR.

It should be noted, in this context, that the Azeri law has been amended to extend the moratorium period, potentially, indefinitely, and this raises the question to what extent any temporary relief granted in the English courts is necessarily required to be extended, until the moratorium allowing the restructuring, comes to a close. It remains to be seen how that question will be dealt with, and no doubt, the foreign representative of the Azeri bank will appeal the decision in Sberbank on this particular ground, amongst, potentially others.

The Way Forward

The Notification, setting out the draft chapter on cross-border insolvency (essentially adopting the UNCITRAL Model Law) is to be welcomed, though it is assumed that it paves the way for India's accession to the UNCITRAL Model Law, rather than the laborious alternative of having to enter into bilateral arrangements with other jurisdictions.

However, as the complexity of the foregoing discussion should highlight, simply adopting the cross-border insolvency regime should not be mistaken to mean that the provisions of the Code will be imported, or its intent applied in foreign jurisdictions. What should be clear, if anything, is that the Gibbs Rule remains good law and foreign creditors will retain their rights under English law financing agreements, notwithstanding an Indian restructuring, assuming of course, that they have not participated in the restructuring or consented to the restructuring plan. Further, it is highly unlikely that a permanent stay on proceedings before the English courts will be granted to a foreign representative of an Indian debtor in the context of a restructuring that has not been implemented within any time bound requirement.

Conclusion

This paper should highlight that cross border insolvency raises a number of complex issues, which essentially, can be simplified by asking two concrete and related questions. Where is the center of control, or main interest of the insolvent entity and where are its assets located? The answer to the first question should determine where

primary insolvency proceedings are brought; and the answer to the second question relates to where secondary foreign proceedings are brought.
Matters of cross-border insolvency should be regulated purely from a procedural perspective and not on substantive matters. Although there may be broad consensus, it would be impractical to suggest a global definition of insolvency; and for that matter; a globally acceptable process in terms of its resolution and the distribution of value between creditors. Each jurisdiction will have its own nuances and therefore, it is surely logical to embrace the idea of a center of main interest in determining primary and secondary proceedings.

In relation to secondary proceedings, potentially across multiple jurisdictions, depending on where the insolvent entity may have assets, the admissibility test should depend upon the recognition afforded to the appointment of any insolvency professional pursuant to insolvency type legislation, acting in the interests of all of the creditors of the insolvent entity (and not just a narrow class of them).

We began this paper with a fictional analogy and perhaps we should track full circle to reflect on what we've learned during this discussion, and illustrate the broader point that legal questions have very practical consequences.

Those Boeing 787 Dreamliners belonging to Woodpecker Airways on the tarmac at Heathrow Airport raised a conundrum. Will Woodpecker be restructured or will it be liquidated? Were those Dreamliners financed by foreign lenders, pursuant to English law financing documents and are they secured by English law security documents? Will those foreign creditors participate in any restructuring plan in India?

If not, will a foreign representative appointed pursuant to the Code, be likely to win a moratorium against the claims of foreign creditors before the English courts in relation to Woodpecker's planes on the tarmac at Heathrow?

The answers, no doubt, will to a certain extent, depend on the appeal in the Sberbank case.

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[2]Public Notice dated 20.06.2018, available at http://www.mca.gov.in/Ministry/pdf/PublicNoiceCrossBorder_20062018.pdf. [3]Solomons v Ross (1764) 1 Hy. Bl. 131n.[4]Galbraith v Grimshaw (1910) A.C. 508. [5]In re Stanford International Bank, 2010 Bus LR 1270 [at ¶ 56]. [6]Ian F. Fletcher, Insolvency in private international Law, Second Edition, 2005 at p. 390.[7]Article 16(3) Model law; see also Virgos, Miguel, and Schmit, Etienne. (1996) Report on the Convention on Insolvency Proceedings, EU Council Document 6500/96 DRS 8 (CFC). [8]H.R. Rep. No.31, 109th Congress, 1st Session, at para 114.[9]In Re Tri-Continental Exchange Ltd 349 B.R. 627 (2006) at p. 635.[10]In re SphinX, Ltd., 371 B.R. 10 (S.D.N.Y.2007).[11]Mackellar v Griffin, [2014] EWHC 2644 (Ch). [12]In Re Northsea Base Investment Ltd, [2015] EWHC 121 (Ch). [13]Article 2(b), UNCITRAL Model Insolvency Law, 1997. [14]For a further discussion of the principle and implications of reciprocity, see 'Should Reciprocity Be a Part of the UNCITRAL Model Cross Border Insolvency Law?' by Keith D. Yamauchi (2007), International Insolvency Review Vol. 16., pages 145-179. [15]Aparna Ravi, Filling in the Gaps in the Isolvency and Bankruptcy Code- Cross Border Insolvency, IndiaCorpLaw, https://indiacorplaw.in/2016/05/filling-in-gaps-in-insolvency-and.html. [16]Sec. 3(23)(g), Insolvency & Bankruptcy Code, 2016. [17]Sec. 426, Insolvency Act 1986 stipulates an obligation on part of the British Courts to assist the foreign representatives from relevant countries in the insolvency proceedings involving attachment of assets situated in their jurisdiction.[18]Gibbs & Sons v. Societe Industrielle Des Metaux, [1890] 2 QBD 399. [19]Professor Ian Fletcher, quoted in paragraph 49 of the judgement. [20]Pacific Andes Resource Development Ltd [2016] SGHC 210 at 48. [21]Article 2(i) of Schedule 1 to the CBIR defines a foreign proceeding as: "... a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation." [22]Article 2(j) of Schedule 1 to the CBIR defines a foreign representative as: "… a person or body, including one appointed on an interim basis, authorised in a foreign proceeding to administer the reorganisation or the liquidation of the debtor's assets or affairs or to act as a representative of the foreign proceeding."[23]Article 21(1) of Schedule 1 of the CBIR. [24]Re BTA Bank JSC [2012] EWHC 4457 (Ch). [25]Ibid. See paragraph 13 of the judgment by Norris J.

Ran Chakrabarti

Ran Chakrabarti is dual qualified in England & Wales and India and a graduate of King's College, London and the London School of Economics. He specialises in Projects & Project Finance, Banking & Finance, Debt Restructuring and International Law. He spent the first 6 years of his legal career in London and Singapore with the finance and projects practices at Ashurst and White & Case, advising multinational corporations and global financial institutions on a range of complex cross-border transactions. Ran moved to India in 2007 to work with a leading Indian law firm before establishing his own niche practice, advising foreign companies and financial institutions on their inbound India work and Indian companies on their outbound joint ventures and acquisitions. Prior to embarking on a career in law, Ran interned with a diplomatic mission to the United Nations in Geneva and the United Nations Department of Political Affairs in New York. The global legal publication, The IFLR1000 2018 and 2019 editions list Ran as a notable lawyer for Project Development & Project Finance with client feedback noting him as a "Great intellectual with a broad knowledge of the Indian legal system."

He would like to acknowledge and thank Sankalp Singh, a Law student at Hidayatullah National Law University for his help in researching and contributing to this paper.

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Use of Blockchain and other new technologies to predict, detect and recover NPAs in Banks

Mrutyunjay Mahapatra

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NPA Landscape

Not very long ago, NPA was a banking term that very few people outside the banking heard or understood. Thanks to multi crore defaults, NPA is in limelight. The CARE Rating Report of December 2017 puts India as the 5th highest NPA nation in the world, only behind the four European economics of Portugal, Italy, Ireland and Greece.

These economies were badly hit due to Euro Debt crisis. India did not have any such crisis, and as such, the market and player are both in search of solutions, end to end. In the past 5 years India's gross NPA levels have risen from about 3 per cent to 10 per cent, Apart from the various other economic factors that has influenced this trend, the new asset quality recognition norms introduced by RBI in 2016, inability due to technological deficiencies and asymmetry of information between lending banks are widely believed to have contributed to this sharp rise in NPAs.

Additionally, priority sector lending, a directed lending programme as well as agriculture loan waiver schemes of various state government contribute significantly towards the accumulation of NPAs. Although both PSBs and private sector banks have accumulated NPAs in the priority sector which is relatively small value compared to the accumulated NPAs in the non-priority sector, given the scale, geographic spread and variety of priority sector NPAs, it is necessary that appropriate technology must be deployed to detect, manage and exit the NPAs on a continuous basis.

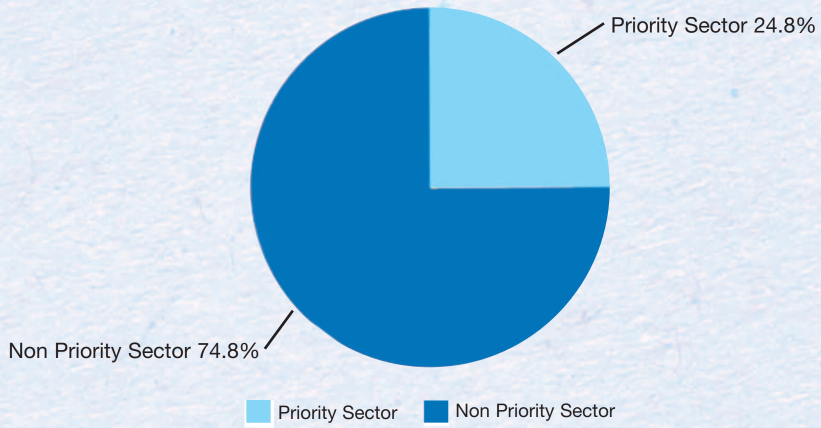

Figure 1: *Public Sector Banks: Gross NPAs as % in priority and non-priority sectors, 2017*
(Source: RBI Database on Indian Economy)

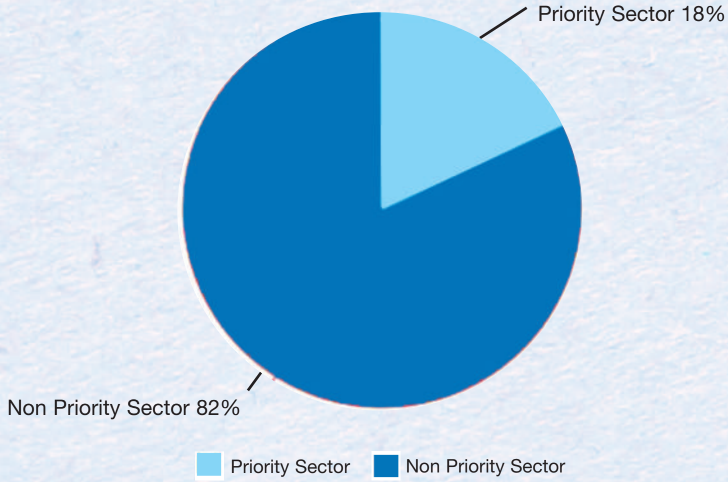

Figure 2 *: Private Sector Banks: Gross NPAs as % in priority and non-priority sectors, 2017*
(Source: RBI Database on Indian Economy)

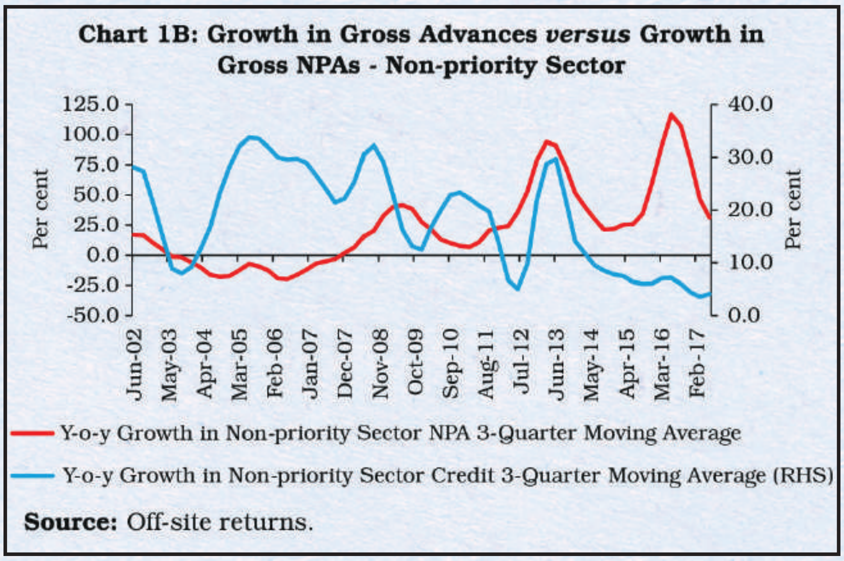

Figure 3: *Non-priority sector: Growth in Gross Advances Vs Growth in Gross NPAs*
(Source: RBI Report on Trend and Progress of Banking in India 2016-17)

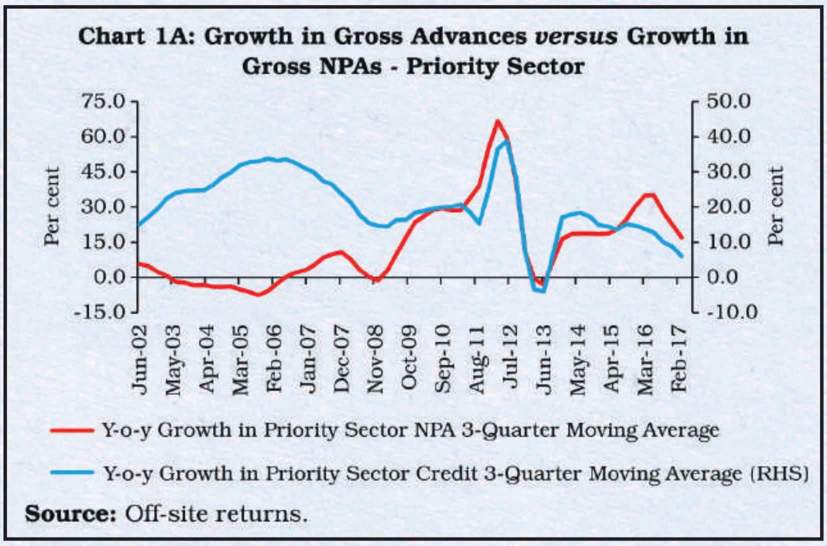

Figure 4*: Priority sector: Growth in Gross Advances Vs Growth in Gross NPAs*

(Source: RBI Report on Trend and Progress of Banking in India 2016-17)

Let us analyse the common root causes of the non-performing assets (NPAs) problem in some detail. On the borrowing entity side, the problems relate to cash and loan misutilisation, suboptimal project management and oversight, invisible and obscure corporate structures, inter corporate/intragroup siphoning, excess leverage on the balance sheets and creative accounting practices. At banks, highly divergent loan appraisal standards, absence of common data base, lack of timely intervention on red flags, excessive use of discretion, reliance on business models with suspect assumptions, non-perfection of security interests, non-enforcement of loan covenants and non-notification to statutory authorities are common problems of NPA management.

The emergence of data analytics and insights as a supplemental and enabling tool is a critical factor which brings into focus the importance of technology in NPA management.

For example, it is observed that there is a correlation between the GDP, Advances Growth and NPA levels. The pattern that emerges is that with a rising GDP, there is a parallel growth in the credit disbursement as substantial part of this GDP growth is fuelled by the credit supplied by the banking system, As long as the GDP keeps growing, the repayment schedule does not get substantially affected and NPA levels will naturally be low. However, whenever the GDP growth plummets, NPA levels tend to increase due to a host of economic factors, primary among them: interest rate, inflation, unemployment rate, and change in the exchange rates etc. This points that Bigdata, insights and real time analysis based on technology are not just important for NPA management but could help in generating early warning signals.

The key focus areas for NPA resolution issue is to first focus on immediate task of resolving the current accumulation in the PSBs and second to focus on long term vision of prevention of further increase of NPA corresponding to GDP growth spurt.
Let us look at how technology can be leveraged to control the NPA issue.

Blockchain

Blockchain was initially came to light as the backbone of crypto-currency 'bitcoin', which is a virtual currency used for digital payments. As Central Banks continue to see crypto-currencies with suspicion and success of bitcoin became a question, alternate uses of the underlying technology behind the bitcoin i.e. Blockchain has garnered widespread interest and applications in various fields of finance and banking. This technology is expected to be a big game changer in business, wherever multiple institutions and individuals are required to complete a value delivery.
To give an analogy, in 1942 as part of project Manhattan, first artificial self-sustaining nuclear chain reaction was developed, later the same was used in the nuclear bombs dropped on Hiroshima & Nagasaki. Later nuclear chain reaction found use in beneficial usages like power generation.
Bitcoin was the first use case that leverages blockchain technology. But today it has gone beyond and has found use in many more cases.

A blockchain is a protocol that offers a decentralised network to verify and validate transactions within a network. A set of validated and verified records is called a block.
Blocks are added by linking to a previous block following the protocol, to form a linear and chronological chain of blocks-a blockchain.

Blocks record when, and in what sequence, certain transactions were entered into the database.
Blocks are verified using computing-power intensive

Blockchain Applications

Blockchain offers decentralisation of control, where authority and trust are distributed across the network. This offers an opportunity to break organisational economic and regulatory control in transaction processing. The following are examples of blockchain applications.

Distributed ledger

The distributed ledger database is spread across several nodes (devices) on a peer-to-peer network, where each replicates and saves an identical copy of the ledger and updates itself independently. Some of world's largest banks have formed the blockchain consortium, R3, to collaborate on a dis tributed ledger for faster, secure, efficient and transparent financial transactions. Nine member banks formed the consortium in September 2015. In just one year R3 has grown to over 50 members worldwide. In India BankChain was formed as community of banks for exploring, building and implementing blockchain solutions. Formed in February 2017, BankChain has 37 members and 22 live projects.

Smart contract

Contracts are stored on the blockchain with defined rules to manage their authenticity, value and ownership. It allows the governance of contracts between parties, eliminating the need for an arbitrator. Technically, a smart contract is a computer programme that is invoked by pre-defined events. Blockchain technology makes smart contracts trustworthy by eliminating the controller and making the programme transparent, efficient and cost effective.

Smart identity

Blockchain technology can be used to store identity records digitally, there by maintaining security and privacy. User education, experience and events data are stored for faster identity verification. Banks can store customer data on blockchain and attach it to customer identity. Users can securely retrieve records and prove identity whenever they need.

Collateral ledger

Blockchain technology enables the posting of collateral in the form of initial and variation margin by escrowing cash on cash ledgers, or assets on asset ledgers, to a distributed collateral ledger. The ledger allows the sharing of collateral information for better evaluation of borrowers' financial and asset positions, auditability and transparency.

Blockchain And Loan Lifecycle Management

'Permissioned' ledgers, smart contract and smart property applications of the blockchain technology can be leveraged to create a decentralised system with distributed control that increases transparency and trust in the management of loans across banks. Since the banking system contains private and confidential data, blockchain technology for this domain entails decentralisation and distributed processing at the bank level. Each bank can become a participant in the blockchain network.

Identity verification of borrowers is faster and more efficient with the use of smart identity in the blockchain network. Shared information provides access to richer information for well informed decision making and consensus. Smart contracts regulate the loan through its lifecycle, eliminating the possibility of incongruent reporting of loans and unreported loans. Shared control in the review of past loan records, verification of financial information, and shared consensus assures efficient governance and transparency in underwriting.

Approved loans are cryptographically signed and immutable. Loan restructuring entails the approval from the distributed network, providing stringent control on data, classification and reporting. The use of smart contracts in post-approval loan classification provides for transparent loan asset classification. It allows faster identification of risky customers with high debt and/ or constrained repayment capacity, as creditor's identities and activities are visible across the network. This in turn reduces the risk of loss of assets. Smart property helps in effective collateral management across banks and faster transference of collateral ownership in case of loss recovery.

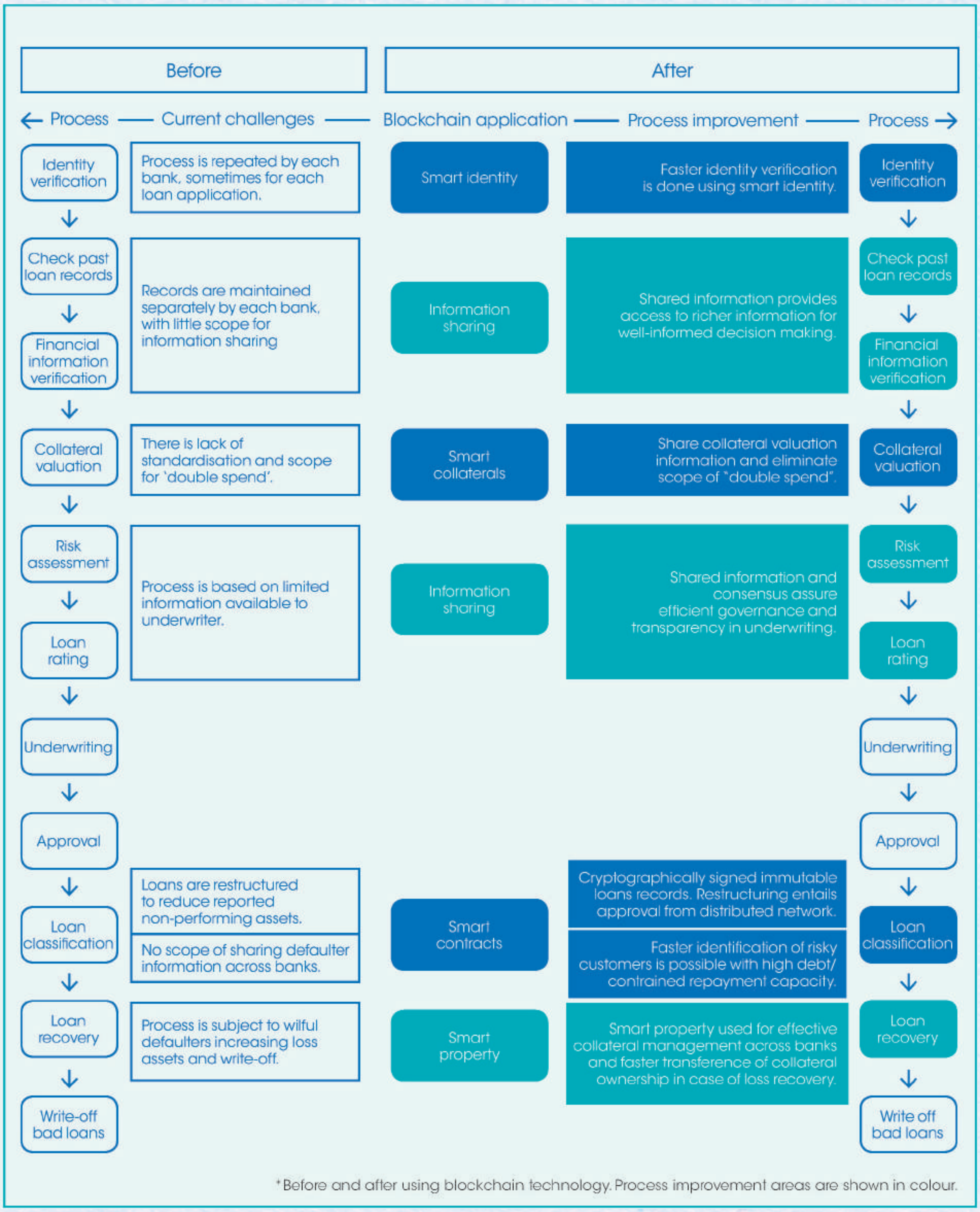

***Figure 5**: Process Improvement, Pre and Post adoption of blockhain technology (Source: Smarter Banking, By Suparna Dhar)*

Big Data & Analytics

Past decade has seen large scale of digitisation in the banking sector which has resulted in generation of large volume and variety of data. Also, most of the customers also generate large volume and variety of data in the social digital space, which we call as Alternate data.

This mammoth amount of digital data of each customer generated both inside and outside the enterprise has potential to reinvent the entire business models and functions of the banking and financial services industry should this data be used in a reasonably scientific and meaningful way.

Big data & analytics focuses on leveraging this large scale structured and un-structured data to derive meaningful insights to help the business. Adoption of big data and analytics is at a nascent stage gravitating mostly towards the lending and risk assessment side, there is very little focus on the collection and recovery segment.
Currently collection and recovery process is manual and generic in many banks. It is not data driven and lacks personalisation. Use of technology which is uniform could be bringing in standardisation, process improvement and improve risk management.

Focused Data Driven Personalised Collection Process

Driving advanced analytics using machine learning models combined with cloud and big data is enabling platform based automation of the advanced analytical process and empowers institutions to perform customer profiling based on their behavioural attributes and facilitates customer profiling which goes beyond demographic segmentation to provide personalised services.

It also helps to predict the propensity of a borrower becoming a defaulter in the future on a real-time basis and trigger pre-emptive personalised follow-up actions for the collection process, the risk of borrower moving into further delinquencies can be mitigated well in advance. Providing personalised services for the borrower after understanding her/ his ability and willingness to pay through real-time data analysis, the lender can create an ecosystem by which both lender and borrower work together to reduce the risk of defaults.

By leveraging the Big Data and Analytics, bank knows at any point of time the collection propensity of every defaulter and what kind of personalised follow-up actions need to be applied on each customer to enhance the collection. The bank also knows for each customer, which collection agent is to be deployed, what personalised message needs to be sent and which communication channel is most effective with a particular customer.

Personalised collection process helps banks to provide data-driven, pre-emptive, precise, focused and targeted collection process resulting in increased recovery and reduced collection costs. This in turn also helps enhanced customer satisfaction and much better customer engagement.

Collaboration With The 3rd Party Integrators

Diversion of funds is among the biggest contributors which is fuelling the NPA growth, Banks have little to no control on how the fund is being utilised.
Due to rapid digitisation and further reduction in cost due to availability of cloud based services and software as a service (SAAS), many of the large to medium enterprises are switching to cloud based enterprise resource planning (ERP) to manage day to day business processes.

ERP keeps track of the key financial transactions of an enterprise: invoices, inventory, account receivables, balance sheet, etc. It keeps a record of business resources like cash, raw material, production capacity — and the status of business commitments: orders, purchase orders, and payroll. If some of these relevant real time data is made available to the banks by the way of consent based collaboration/integration between the enterprise ERP system and bank system, Banks will be in a better position to take informed decisions. On the basis of the data, they can predict when and how an enterprise will start losing traction, weeding out wilful defaulters and track end utilisation of the funds released. Banks can monitor the finances of an enterprise in real time if they are red-flagged.

Early Warning Systems

The most effective means against the default of loans is the early identification of non-performing loans. By gaining time, effective measures can be taken to prevent a loss. Sufficient time for a response and taking the correct actions are the biggest assets in successfully handling of a non-performing loan.

Early warning systems can be an important tool to mitigate credit risks through proactive monitoring. However, first level coordination and actioning is largely manual. Use of Robotic process automation (RPA) with EWS analytics can improve and fortify quick action on EWS. At the resolution stage, collaboration for security valuation, notification of common resolution and recovery strategy, etc. could be enhanced by using big data points like similar transactions, zone prices, purchase price history, etc.

With RPA and blockchain, base lining and registry searches of prices could be highly transparent, data based, reliable and accessible.

Technology enabled building blocks of EWS are the following:

- Analysis of trends in NPAs of the bank including factors leading to NPAs
- Analysis of trends in credit portfolio diversification
- Studying the relationship between diversified portfolio and NPAs of the bank
- Profiling and analysis of concentration risk in the bank
- Evaluating the credit risk management practices in banks

Additionally, due to process enhancement and strong database automation, decision making is expected to be transparent with auditable and well documented transaction trails. These are expected to help reduce the fears of later accountability from the minds of the bankers, a major impediment in rebooting of the system. As observed in the consumer space, the confidence level of successful utilisation of analytic technology is very high in general. Given the general acceptance of data science and RPA at policy making, legislative and the operational levels, the ecosystem is conducive.

In summary, Blockchain usage for NPA management is beneficial for multiparty secured sharing of information. Other technologies like data engineering, ML and deep learning, IOT based triggers should be combined with blockchain to make the loan management system in general and NPA in particular to be greatly efficient and robust.

Mrutyunjay Mahapatra

Mrutyunjay Mahapatra joined Syndicate Bank as MD & CEO on 21.9.2018. Mrutyunjay Mahapatra is a post graduate in Physics and Business Management. He had varied stints in State Bank of India, in the country and abroad for over 35 years. He has worked extensively in Corporate Credit, Leasing, Global Strategy, Payments, Transactions, General Management and Transformation Programmes at SBI. Till recently as the Deputy MD (Strategy) & Chief Digital Officer and CIO of State Bank of India, he has handled IT, Data and Analytics, Innovation of India's largest Bank and SBI Group. He has worked on Boards of several Indian and Global companies. He is a well-known public speaker and regularly writes for leading newspapers and periodicals

We acknowledge his contribution and are thankful for the same.

IBC 2016 : The NCLT Experience And The Way Forward

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The Insolvency and Bankruptcy Code, 2016 ("the Code") came into force on 28th May 2016. It was heralded as a revolutionary reform in the field of corporate insolvency which ushered in an era of insolvency resolution in a time-bound manner to maximize the value of assets of such persons while balancing the interests of all stakeholders.[1] Though insolvency resolution has been mired in litigation since the advent of the Code, the National Company Law Tribunals ("NCLT"), which are the 'Adjudicating Authority' under the Code, have been quite pro-active in upholding the spirit of the Code. Our NCLT experience with the Code and changes to plug the loopholes encountered in the way has been quite interesting, to say the least.

The NCLT, established under Companies Act, 2013, was accorded additional powers under the Code to deal with insolvency and bankruptcy proceedings. Previously, there were multiple fora, which led to forum-shopping by creditors. The resulting quagmire prompted this step, and thus, the NCLT alone, along with its appellate tribunal (NCLAT), became adjudicatory bodies with the function of keeping the process a fair and efficient one, keeping the interests of all stakeholders in mind. There is no doubt that the current mechanism has been far more effective than the previous Debt Recovery Tribunals (DRT) where long delays were the characteristic feature.[2] The procedure for making an application under the Code is the same as any other company matter before the NCLT, including the specific ways a type written application is to be submitted. The process is being revamped, and the NCLT Delhi has started the process of E-Filings in India which will make way for safer records and lesser paperwork. The E-Filings are immensely convenient, and their popularity can be seen in the figures — it was effected at the end of August 2018, and as of date, 6099 E-Filings have already been made.[3] The Code has been increasingly beneficial to the creditors with the mean recovery rate for India having increased from 20 per cent in 2015 to 41.6 per cent (for cases till September 2018).[4] It has also been preferred in large numbers by operational creditors, who are usually unsecured creditors and hitherto have no effective remedy other than civil suit and initiation of winding up procedure in court.

However, there have been certain setbacks and some amendments have been made to dynamically increase the efficiency of the Code and deal with the issues in it as and when it arrives.

First and foremost is the issue of timeline for the proceedings. At the outset, there were apprehensions regarding how the NCLT would function with a fresh influx of cases that would come up due to the Code coming into effect, and that the NCLT would be overburdened. Happily, the NCLT has managed admirably, despite the large number of applications. According to a recent analysis,[5] the NCLT took an average of 24 days to dispose of a case compared to the 14 days visualized by the Code. Taking into account all the cases before the NCLT till November 2018, we see that around half the cases took up to 34 days to decide on an application.[6] This timeline of deciding cases within 14 days was considered to be just a tool of aid in the expeditious dispensation of justice and thus declared discretionary.[7] The Hon'ble Supreme Court also held that the time limit mentioned in Section 12 for the completion of insolvency resolution process (180 days with a maximum extension of 90 days) is mandatory and needs to be followed strictly.[8] However, keeping in mind the delays caused by litigation, the Supreme Court has allowed for exclusion of the litigation period from the calculation of 270 days[9] and stated: "A reasonable and balanced construction of this statute would therefore lead to the result that, where a resolution plan is upheld by the Appellate Authority, either by way of allowing or dismissing an appeal before it, the period of time taken in litigation ought to be excluded. This is not to say that the NCLT and NCLAT will be tardy in decision making." Earlier, the NCLAT had also taken the same view[10] and stated: "…it is clear that if an application is filed by the 'Resolution Professional' or the 'Committee of Creditors' or 'any aggrieved person' for justified reasons, it is always open to the Adjudicating Authority/ Appellate Tribunal to 'exclude certain period' for the purpose of counting the total period of 270 days, if the facts and circumstances justify exclusion, in unforeseen circumstances." This has in effect led to a dilution of the legislation which has affected 30 per cent of cases undergoing resolution (as on September 2018) which have already exceeded the 270 days limit and are cases where the resolution is still going, in contrast to the legal mandate of liquidation to commence on exceeding the 270 days limit.[11]

The second issue is the stage at which the interference of the NCLT in Insolvency Resolution Process is required. The 2015 Report of the Bankruptcy Law Reforms while putting down recommendations for the Code, noted that the adjudicator will be directly involved once it is determined that the debt is unviable and that the entity or individual is bankrupt.[12] The Hon'ble Supreme Court held in an earlier hearing of the Essar Steel case that the NCLT and NCLAT should refrain from interfering in insolvency resolution proceedings, thus making it clear that their role comes only after resolution plan is finalised. The Supreme Court has forbidden any litigations from any stakeholder over a resolution plan before it is approved by the Committee of Creditors.[13]

The third issue deals with the extent of the interference of the NCLT. While drafting the Code, once the proceedings are initiated, the resolution plan of the debtor was to be left to commercial forces, this was one of the factors that made the 180 days' timeline envisioned in the Code plausible.[14] However, until recently, the NCLT not only interfered before the resolution plan was finalised, but also sought to go beyond the grounds set out in the Code. While the law has laid down the specific ground for dismissing an insolvency case, the NCLT has dismissed petitions on extraneous considerations as well.[15] In some cases, where even if all the conditions have been fulfiled, the application has still been dismissed by looking at balance sheets and in some instances even ascribing motives.[16] This is an issue that needs to be addressed and rectified, and the NCLT may consider limiting its role.

The last major issue is the concept of an out-of-court settlement between the creditors and the debtors. An individual claim for recovery for money leads to part by part settlement which can end up being a never-ending process. Under the Code, a settlement could be carried out by making an application of withdrawal under Rule 8 of the Insolvency and Bankruptcy (Application to Adjudicating Authority Rules), 2016[17] before the admission of the application by the Adjudicating Authority. The provisions pertaining to withdrawal after the admission of the application are unclear. This led to a confusing trail of judicial precedents. In Lokhandwala Kataria case[18] the court was met with the question whether the NCLT, while applying Rule 8, could utilise the inherent power recognised by Rule 11 of the tribunal Rules, 2016 to allow a compromise before it by the parties after the admission of the matter.[19] The Hon'ble Supreme Court rejected this proposition but in a much contentious move, allowed the settlement utilising their powers under Article 142 of the Constitution of India "to put a quietus to the matter before [them]."[20] The Court also held in a later case that since the power of Article 142 was only of the Supreme Court, the relevant rules may be amended by the competent authority so as include such inherent powers.[21] In parallel, the Binani Cement insolvency petition brought out how settlements could be used as a means by the parties to exit the insolvency process. It went to court after the resolution plan had been submitted and approved by 99 per cent of the creditors, the Court refused to allow the settlement.[22] Finally, Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 was promulgated on June 6, 2018.[23] The Ordinance inserted Section 12A which allowed withdrawal of application admitted under section 7, 9 or 10, on an application made with the approval of ninety percent voting share of the committee of creditors. Thus, the amendment allows withdrawal after admission but also makes sure that the insolvency remains a collective proceeding against the debtor rather than just an individual claim for money. Section 12A allows the Adjudicating Authority to decide each application on a case-to-case basis.

Thus, in conclusion, the Code has largely exceeded expectations and is working smoothly with minor setbacks. The timelines set by the Code are reasonably met with transgressions that are arguably minor. The extent of interferences of the NCLT has been kept at a bare minimum with adjudication to be only allowed at the end of the proceedings. Finally, the recent 2018 amendment clears doubts about the stance of out-of-court settlements after the acceptance of the application under Section 7, 9 or 10. Thus, the NCLT experience has been more or less smooth and is paving the way forward for the Code and its application.

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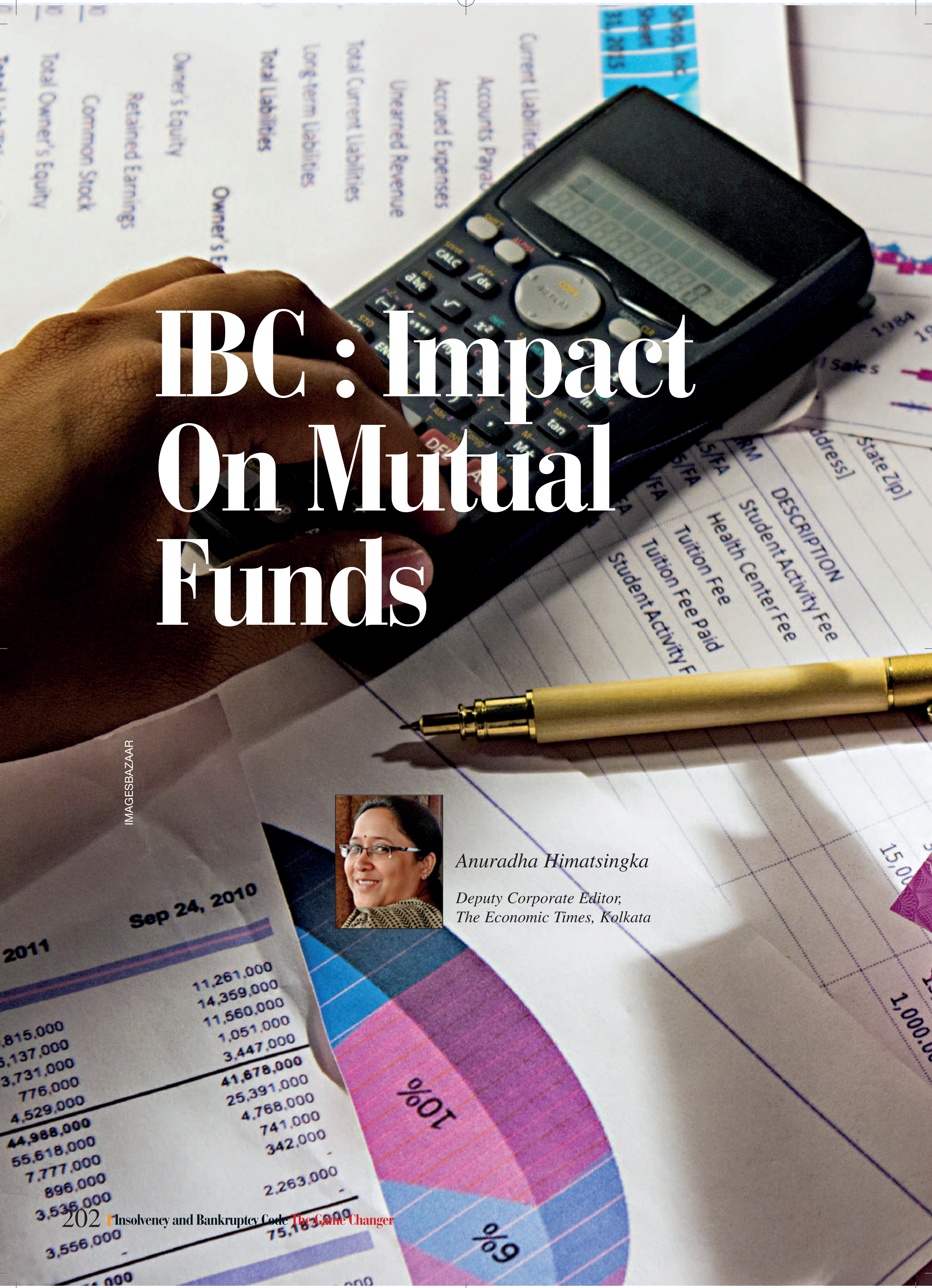
We acknowledge their contribution and are thankful for the same.



IMAGESBAZAAR

IBC : Impact On Mutual Funds

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Fixed income investments are considered to be safe, more so if it is done through mutual funds (MFs). Defaults in the past few months have shaken the confidence of investors, but recoveries could be quicker and assured unlike in the past when it would take decades to do so.

The Infrastructure Leasing & Financial Services (IL&FS) saga showcases the shallowness of the Indian debt market and credit assessment, but at the same time holds the prospects of a methodical resolution of default and hope of investors getting some of their money back.

Implosion of IL&FS with about ₹90,000 crore in debt threatened to engulf the financial markets with India's own Lehman moment, but the existence of the National Company Law Tribunal (NCLT) and the bankruptcy law are rays of hope in the moment of despair.

Contrary to claims by the mutual fund industry that its investments in the debt-ridden IL&FS are safe, action by rating agency Icra has indicated negative implication for the sector.

The rating agency has downgraded one scheme of Aditya Birla Mutual Fund and put five other schemes of HDFC Mutual Fund and UTI Mutual Fund under rating watch due to their exposure to the special purpose vehicles (SPVs) of the troubled IL&FS.

It has downgraded Aditya Birla Sun Life Short Term Opportunities Fund to 'AA' from 'AA plus' due to an exposure of 1.15 per cent of the scheme's AUM to Jharkhand Road Projects Implementation Company.

Other schemes that have been put on rating watch are: HDFC Short Term Debt Fund, HDFC Banking and PSU Debt Fund have an exposure of 0.55 per cent and 0.29 per cent to Hazaribagh Ranchi Expressway (HRE), respectively. The exposure of UTI Banking and PSU Debt Fund, UTI Bond Fund and UTI Dynamic Bond Fund to Jorabat Shillong Expressway (JSEL) was 6.87 per cent, 5.98 per cent and 6.25 per cent, respectively.

"The rating action takes into account the deterioration in the credit quality of the underlying investments of these schemes driven by their exposure to the SPV of IL&FS Ltd," Icra said in a statement. In case of delay in honouring obligations, the ratings of these SPVs are likely to be downgraded impacting the credit score of the mutual fund schemes, the rating agency added.

Icra noted that the schemes have exposure to Hazaribagh Ranchi Expressway Ltd or Jharkhand Road Projects Implementation Company Ltd or Jorabat Shillong Expressway Ltd. The default risks of the various SPVs have increased given the recent communication by their management to the trustees of these schemes, seeking stoppage of future repayments based on an order of the National Company Law Appellate Tribunal (NCLAT) dated October 15, 2018, the rating agency said. The NCLAT had passed an interim order on October 15, granting a moratorium on all creditor actions against IL&FS and its group companies.

Subsequently, in January 2019, two SPVs of IL&FS demanded a refund of the debt payment executed by them post October 15, 2018, from their trustees. Despite a ring-fenced structure and adequate cash flows to service the debt obligations, the SPVs have asked the trustees to stop debiting the escrow account towards future obligations. But that has since been relaxed with the administrator trifurcating the group companies into three - green, amber and red - depending on their ability to pay off debts from operating cash flows.

Stake holders addressed under IBC

Clearly, India's debt funds are passing through testing times. The IL&FS default was followed by the implosion of Zee group promoter Subhash Chandra's Business Empire where he had borrowed pledging shares of Zee Entertainment and other group companies. Dewan Housing Finance (DHFL) downgrades added to the woes. All collectively threatened to upend India's debt mutual fund space. With DHFL group companies' debt mess coming under lens, global brokerage Credit Suisse warned industry that the development could trigger a second wave of risk aversion in India's debt fund industry.

"The DHFL debt mess is expected to have a resonating effect as the company is among the larger borrowers from MFs and their aggregate exposure stood at around ₹8,500 crore as of December 2018," the brokerage said.

Several fund houses have large exposures to DHFL, at 2-10 per cent of total debt AUM, with some schemes having up to 30 per cent of their AUM to DHFL, Credit Suisse said. UTI Mutual Fund had the maximum exposure of around ₹2,144 crore as of December 31, 2018, followed by Reliance AMC at ₹1,488 crore, Axis AMC at ₹771 crore and Franklin Templeton ₹571 crore. Some schemes have taken mark-to-market (MTM) losses on this exposure with DHFL paper being repriced at higher yields. Credit Suisse warned if this continues and leads to redemption pressure, it may cause a wave of risk aversion in domestic debt funds and volatility in their flows. The DHFL issue may also result into more scrutiny of credit risk in debt funds, and considering the fact that NBFC funding relies on MFs for 10-30 per cent of their resources, debt funds flow will see some hiccups in the coming days, the global brokerage said.

Information available in the public domain on the Essel Group revealed — more than ₹ 8,000 crore worth of bonds and debentures issued by group companies are held by 150 debt mutual funds. Of this, ₹6,329 is invested in 60 open-ended debt funds while the balance ₹1,672 crore is in 90 fixed maturity plans (FMPs). The Aditya Birla Sun Life Mutual Fund is the biggest investor, with an exposure of ₹2,936 crore spread across 28 schemes. This is almost 37 per cent of the total debt fund exposure to the Zee group.

One scheme alone has ₹1,288 crore invested in Zee group bonds. As on December 31, 2018, the Aditya Birla Sun Life Medium Term Plan held zero-coupon bonds worth ₹720 crore issued by Sprit Infrapower & Multiventures Pvt Ltd. (credit rating A) and ₹568 issued by Adilink Infra & Multitrading Private Ltd (unrated). The two holdings account for 12.5 per cent of the fund's total ₹10,272 crore portfolio and are its top holdings.

Another scheme, the Aditya Birla Sun Life Credit Risk Fund, held ₹740 crore worth of zero-coupon bonds of Sprit Infrapower & Multiventures Pvt Ltd. and Adilink Infra and Multitrading Private Ltd. The two holdings account for 9.2 per cent of its portfolio, with Sprit Infrapower as its top holding (5.62 per cent). The Aditya Birla Sun Life Dynamic Bond Fund has over 8 per cent of its ₹5,136 crore portfolio invested in Sprit Infrapower bonds.

In percentage terms, Baroda Mutual Fund schemes have the largest exposure to bonds issued by Zee group companies. As on 31 December 2018, the Baroda Credit Risk Fund had ₹168 crore invested in zero-coupon bonds of ARM Infra & Utilities Pvt Ltd. and Cyquator Media Services Pvt. Ltd. Together, this is 17.7 per cent of its ₹947 crore portfolio.

Unnerved by the spate of downgrades and threat of defaults in the debt MF space, conservative investors, especially short-term investors who have invested for less than three years, want to shift to fixed deposits due to the safety concern as there is no tax differential between the two when it comes to short term gains.

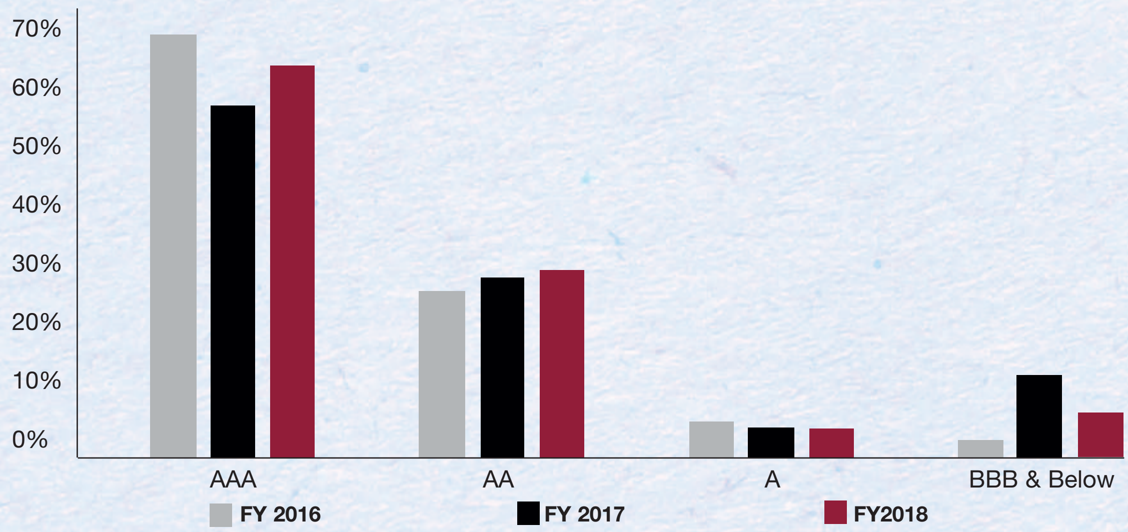
While experts suggest investors must be cautious of funds with higher yield to maturity and concentrated debt portfolio, besides urging them to read fact sheets before investing in any fund. Some in the industry feel that the developments including the IL&FS crisis will not have much impact on the overall inflow into the industry's debt fund schemes as investment decisions are made on the individual portfolio of a particular scheme.

The markets regulator has done its bit to save investor value by introducing a concept called 'Side Pocketing' where hard to value assets during defaults would be kept separately without being part of Net Asset Value calculation. Once resolved, the value realised would be distributed among unit holders.

Independent of the IL&FS crisis, the inflows into money market and liquid schemes have been volatile in the last few months. For instance, the AUM (assets under management) of the industry dipped 5 per cent December to ₹22.85 lakh crore against ₹24.03 lakh crore in November. In December 2018, investors pulled out ₹1.48 lakh crore from money market and liquid schemes against net inflow of ₹1.36 lakh crore logged in November.

Before analysing the Insolvency and Bankruptcy Code (IBC) and its impact on MF industry, one needs to understand IBC's impact on the bond market primarily because mutual fund schemes do not extend loans but invest in bonds. When the code impacts the country's bond market as it did in the IL&FS case, the MF industry gets impacted. Presently, about 90 per cent of trading is restricted to AAA and AA rated categories. In other words, mutual fund managers invest in AAA and AA rated papers as probability of default of these securities is low. They do not invest in lower rated bonds

Distribution of bond issuances by rating category (fiscals 2016. 2017 and 2018



like single A and triple B although they are in the investment category primarily because the country did not have well-defined time bound recovery guidelines.

Aditya Birla Sun Life AMC CEO A Balasubramanian said: “Current IBC process gives protection to secured lenders including the holding by MFs in such companies. While such investment in the MF portfolio may take a temporary hit in the form of a fall in NAV, as it recovers its money under the IBC resolution process it gets made up over time.”

MFs normally invest in secured papers and hence, if any of the borrowers go to NCLT under the IBC process, investment in such companies may also be included in the order of priority between secured and unsecured creditors, he added.

Following the implementation of the bankruptcy code which facilitates recovery of dues from defaulting instruments, MF managers are less worried about the recovery prospects in case securities default. Going forward, as IBC legislation gets streamlined, it will have a positive effect on the country's bond market. India's bond market too will become deeper and broader as more bonds get issued.

A joint study conducted by Assocham and rating agency Crisil sometime in October 2018 corroborates the industry view. It has noted that India’s corporate bond market, which contributes 16 per cent to the country’s gross domestic product (GDP) and is highly concentrated in the AAA rated bonds, is expected to change once the Insolvency and Bankruptcy Code brings about successful resolution of stressed assets in a time-bound manner.

Corporate bonds market penetration in India is very low

Country	Distance to frontier* *(under ‘resolving insolvency ‘ parameter)*	Recovery rate* (%)	Time* (Years)	Corporate bonds/ GDP ratio*
India	**40.8**	**26.4**	**4.3**	**16%**
China	55.8	36.9	1.7	19%
Singapore	74.3	88.7	0.8	32%
Malaysia	62.5	81.3	1.0	46%
South Korea	84.7	89.3	1.5	73%
US	91.1	82.1	1.0	120%

***Source** : *World bank’s Doing Business 2018 report’: A higher score on ‘distance to frontier’ indicates a stronger insolvency mechanism; CRISIL Research*

The study noted that effective implementation of the IBC can help improve the recovery rate of stressed assets further, as has been proven internationally. “So far, recoveries by Asset Reconstruction Companies (ARCs) have remained below expectations as resolutions were lengthy. Smaller assets (debt up to ₹1 billion) typically have a shorter resolution time frame and better recovery rate compared with larger ones.”

"While the sale of assets or settlements is the most preferred and successful strategy for small accounts, reconstruction was the most preferred strategy for large accounts. But large accounts, during reconstruction, could take a legal recourse, delaying the recovery proceedings. This would remain a challenge for an effective resolution within the proposed timeline," the study said.

The study also notes reduction in the timeline for resolution of stressed assets under the IBC would not only enhance confidence of investors but would also make them go in for bonds less than AAA rating.

With greater certainty of outcome and expectations of a faster resolution of non-performing assets, because of the IBC, the interest of both domestic and foreign investors in lower-rated Indian debt instruments in the investment grade will increase over time, the study noted.

Further, "once the code stabilises — over the next three years or so and a track record of recoveries gets built up - the industry will have a database of recoveries happening from defaulted instruments in different sectors, and the time frame within which the recoveries happen. The database could be industry specific also and not just, company specific," said Krishnan Sitaraman, senior director at Crisil.

For example, if an A rated bond from a steel sector defaults, investors will be able to get an input what is the recovery they can expect and the time-frame within which the recovery would be achieved. This can help in better pricing of such instruments.

"This is the kind of data which would come to the fore once IBC stabilises. Availability of a strong database will help fund managers invest in a single A and triple B rated papers in informed way going forward, thus potentially expanding the Indian bond markets which is now largely restricted to AAA and AA rated instruments." Sitaraman added.

Globally, MFs have a gamut of bonds in which they can invest. In case of a default, fund managers remain unruffled as they have time bound recovery rules. In US, UK or even Japan, investors recover as much as 80 per cent to 90 per cent of their total investment on an average and within a short span of one-to-two years. Compared to the US or UK, the recovery level in India is averaging around 25 per cent (in some cases a little higher and in some, lower) over a period of four-to-five years. However, India will be able to improve its recovery percentage once the bankruptcy code stabilises.

Countries such as Brazil, Russia, China and the United Kingdom had taken steps to reform the bankruptcy laws which, along with other government-specific macro economic structural reforms, led to significant growth in the corporate bond markets in their respective financial markets. The ratio of the bond market to GDP more or less doubles five years post the introduction of legislation vis-a-vis five years before the legislation came into force.

Balasubramanian as well as a high net worth individual, who did not wish to get quoted, feel the bankruptcy code is the best resolution process that India has created in the recent past to address the need of faster resolution under a separate law to revive the fortunes of borrowing companies and thereby, protect the interest of lenders and investors.

Corporate bonds-to-GDP ratio nearly doubles five years after bankruptcy reforms

Country	Year of reforming bankruptcy laws	Five-year average (pre-reforms)	Five-year average (post reforms)
Brazil	2005	12.70%	26.30%
Russia	2009	8.10%	13.10%
India	2016	17.90%	Effect to be seen
China	2007	18.80%	33.40%
UK	2002	68.40%	106.80%

Source *: Bank for International Settlements*

In the long run, effective implementation of the IBC will help in preserving the value of asset and faster resolution. That, in turn, means ARCs will be able to churn capital faster and enhance returns, industry sources pointed out.

The Reserve Bank of India's recent proposal to allow bidders for insolvent companies to raise funds through external commercial borrowings (ECBs) to repay existing lenders has also brought cheer to MF industry.

RBI proposes to relax the end-use restrictions under the approval route of the ECB framework for resolution applicants under Corporate Insolvency Resolution Process (CIRP) and allow them to utilise the ECB proceeds for repayment of rupee term loans of the target company. Access to relatively cheap foreign capital would aid early resolutions and also make the process cost efficient, legal experts said. According to existing norms, the proceeds of ECBs, in either foreign currency or Indian rupee denominations are not permitted to be utilised for repayment or for on-lending for repayment of domestic rupee loans.

According to Icra, timely conclusion of CIRPs of pending entities could have brought in additional ₹65,000 - ₹67,000 crore to the financial creditors, which is equivalent to about 6.5 per cent of the gross non-performing assets in the banking sector. "This is a sizeable figure when we consider that the 79 corporate resolutions that have yielded a resolution plan so far have helped the financial creditors realise an aggregate amount close to ₹65,000 crore, to be received either upfront or in a staggered manner," the rating agency said.

Icra vice president and co-head corporate ratings Abhishek Dafria too feels that the introduction of IBC has boosted the M&A activity which is a positive for the MF industry as it increases the financing requirements in the country and could also widen the issuer base.

The IBC may achieve what regulatory efforts for decades did not do — a vibrant market facilitated by the mutual fund industry.

We acknowledge her contribution and are thankful for the same.

Stress to Come

The quantum of non-performing assets is still too high for comfort and will be a major pain in the forthcoming fiscal

Non-performing assets problem in industries had been a constant cause for the slow performance of the Indian economy. Its magnitude is thought to be larger than what can be perceived at present, though goverment statistics indicate that its growth is on a decline.

According to the bi-annual financial stability report published by the Reserve Bank of India, it is evident that bad assets problems of the banking sector in the country is receding for the first time since 2015. Banks have shown an overall improvement with their gross NPA (GNPA) ratio declining from 11.5 per cent in March, 2018 to 10.8 per cent in September, 2018.

The build up of stressed assets have been for reasons more than one. The apex bank's findings point towards the deterioration of macroeconomic conditions from the domestic and world economic perspective. This led to the general slowdown in world's trade and business. Demand for goods and services fell and dipped to new lows. Further, failure of India's leading infrastructure finance company IL&FS on payments to lenders triggered panic in the markets. Low capacity utilisation in other core industries such as power and iron and steel contributed further to this slowdown. Stagnant economic conditions at home and abroad have also led to stressed assets to increase in other core industries such as mining, food processing, and construction.

It is now feared that if this situation fails to improve significantly and fails to effect considerable changes to basic economic indicators, the gross non-performing assets ratio could worsen.

RBI classifies a loan or an advance as an NPA if its interest and or instalment of principal remain overdue for a period of 90 days. Assets, including leased assets, become non-performing when it stops generating income for the bank.

'Stressed assets' are accounts where there has been delay in payment of interest or principal by a stipulated date although they may not be classified as NPAs

A common problem in the above mentioned industries is delays in project implementation because of challenges such as land acquisition, approval of required permits and environmental clearances. They have added up to cost overruns, particularly in the mining industry segment.

It may be noted here that India's mining sector contribution to GDP is low compared to major mining countries such as China, the United States, Australia, Brazil and Chile. India currently ranks low on both policy potential index and mineral potential, making it unattractive as a mining investment destination. It is ranked 59th out of 96 mining jurisdictions on composite mineral and policy potential.

Yet another key underlying issue that is common across these major industries is the unavailability of key fuel such as coal and its linkages. Power generation, steel and cement manufacturers suffer from shortage of high calorific coal as its key raw material input. Thus, their imports of high quality coal are high.

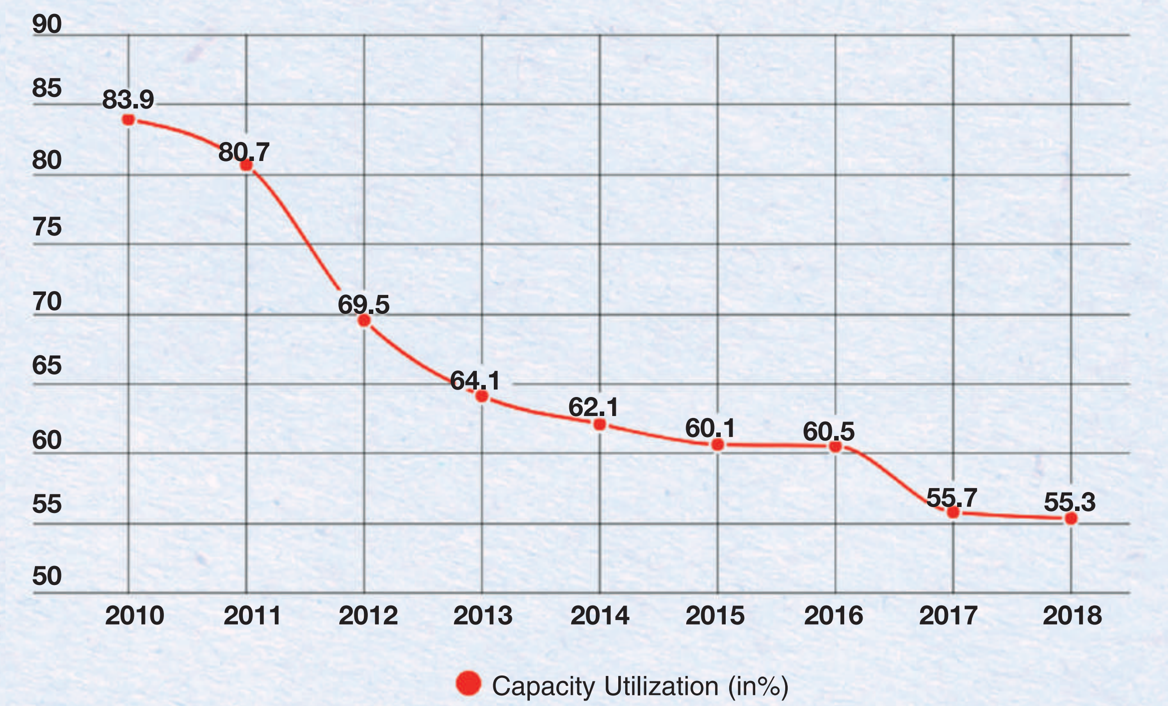
Mine closure critically affects sustainable development and needs to be addressed through regulatory measures. Currently, the financial guarantee for mine closure is very low in India and does not sufficiently deter defaulters. India is dependent on imports of nonferrous mineral to a large extent and is, thus, vulnerable to supplies and price fluctuations. Also, the mining sector faces challenges in the wake of low commodity prices, forcing companies to keep costs under check and operate at a lower profit level. Concerned about coal projects worth over ₹11,000 crore facing delays, the central government had asked Coal India and NLC India Ltd to address the reasons behind the growing mess. The matter had come up when projects worth ₹35,000 crore came under review at a time when India was importing significantly large quantities of coal.

The review meeting covered 51 projects of Coal India which accounts for over 80 per cent of the domestic dry fuel production, nine of NLCIL — formerly Neyveli Lignite Corporation - and two belonging to Singareni Collieries Company Limited.

The Standing Parliamentary Committee on Energy report states that 15 GW out of the stressed 40 GW is yet to be commissioned.

Another 16.2 GW of coastal power plants designed to operate totally on imported coal are affected with cost escalation and high interests for over two years till date. Gas fired

Capacity utilisation at private coal-based power plants (in%)



Source : ET

projects to the tune of 6 GW have been stranded by supplies from India's limited domestic gas production. Plants have failed to reach the required viable cost utilisation rate. Imported liquid natural gas is expensive and its price in the world market is surging.

It is estimated that the power sector owes loans of more than ₹1.74 lakh crore that are on the verge of being classified as NPAs, as stated by the Parliamentary Standing Committee on Energy presented in the Lok Sabha earlier. A total of 34 thermal power projects were identified by the committee as being 'stressed'. Out of these, 32 thermal power generating plants belong to private companies while only two are from the public sector. In fact, stressed assets make up around 17.67 per cent amounting to ₹98,799 crore of the total advances given out in the thermal power sector as of June 2017.

The capacity of these stressed thermal power plants amounts to 40,130 MW. Out of the total stressed capacity, about 24,405 MW is the cumulative capacity of plants that have been commissioned. The remaining 15,725 MW is under construction and not yet commissioned.

\Indian banks are already saddled with huge bad loans threatening the entire banking system. The severity of the problem may lead to a situation where the gross NPA ratio for public sector banks may increase from 15.6 per cent in March, 2018 to 17.3 per cent by March, 2019. For private banks, the ratio could to 5.3 per cent as per RBI, while for foreign banks it could reach 4.8 per cent by March, 2019.

Thus, it is a fact that the magnitude of non-performing assets at present is still too high for comfort. A RBI report states that non-performing asset recognition is likely to get prolonged till the next fiscal year and can put ₹5.24 trillion debt at risk in the financial year 2020. The number of failing businesses in private and public sectors will rise and will act as a load weighing down a quick and smart growth in India's economy.

However, this situation will also serve as a catalyst for the government creating new policies that could lead to a sustained growth in the near future.

The Best Of Assets

Liquidation of assets is the last option as many stressed assets have high values which needs to be realised optimally

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The process of liquidation and giving up all through a distress sale could jeopardize the revival of core industries such as steel and power generation in India, and thus lead to a slow growth of the economy as a whole. There is a growing thought now to critically look to pick out good assets from a milieu of the non performers in order to derive their maximum value during a resolution process.

It is true that the bankruptcy filings of some of the large non-performing companies with the NCLT is a welcome step in resolving the long overdue distressed asset situation in India. It does set a trend that is likely to increase as more and more cases are being filed for the quick resolution process.

The present economic scenario in India does not display a rosy picture for industrial development in the immediate future. Rather, it portrays a situation where development will be slow, though somewhat steady.
The current industry downturn and a relatively young law bring up the challenge of finding suitable buyers for the beleaguered industries. There is an apprehension that many of the large assets may not find immediate buyers. Their hasty sale could lead to deep discounts.

Not all assets are bad. Much of India's stressed assets up for the liquidation process have significantly higher inherent values. Thus the value of productive assets needs to be credibly and transparently brought out in terms of its optimum cash-flow generation ability and sustainability of its business models under a reorganized plan. This would certainly encourage enhanced participation from domestic and international investors and minimise their potential write-downs. This would lead eventually to lower bank recapitalisations.

Therefore, there is an urgent need to critically analyse the technical viability of all cases that come up for resolution. Though the primary focus of the Code lies in creditors getting the most, the need is also to weed out the non performers and set aside the good and better assets in a separate entity. This would help create a situation where the profitability of the good assets can grow and thrive in the near future.

Recent observations by industry consultants points out that major causes for companies to fall in distress are high costs of borrowings, fundamental defects in the underlying business models, poor technical and management capability and operating practices. Then there are other corporate businesses which have wilfully diverted funds and resorted to financial indiscipline.

There were initial fears that approach to resolving distressed assets through a fledgling bankruptcy system would lead to liquidation rather than reorganisation, and hence it would be prudent to preserve the good assets for future use.

Whether the above apprehension washes away with the success of the Code or creates a platform for prolonged litigation locking up distressed assets, can only be answered with time. A successful adaptation of the new law to various requirements on a case to case basis is also a necessity.

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It is true that the Indian core industry faces a plethora of problems due to global and domestic factors, turning many of them sick. Globally, commodity prices have remained subdued because of low demand. Industry at home suffered due to over capacities with demand falling in domestic and world markets. New economies have emerged as stiff competition to Indian goods and services.

Further, there were changes in policies and orders that jeopardised projects from seeing the light of day. For example, the cancellation of mine deals has hit infrastructure development in the country hard. However, these are business hurdles that entities should have been able to address and overcome in time.

Many experts believe that much of underlying physical assets of distressed companies are productive high-quality assets. With the appropriate interim turnaround management and capital support, they can be restructured, reorganised, and eventually sold at better value to the best of bidders.

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It is possible that insolvency resolution personnel may not be adequately equipped with experience or competence to have an in-depth knowledge to guide and execute a transition and turnaround required for such huge bankruptcies — the kinds that the Indian industry is witnessing. However, it may be noted that in certain cases insolvency resolution personnel have invited competence of experts to assess the liquidation asset value of some of these mega stressed assets. Successful resolution of stressed assets should attempt to preserve maximum economic value through restructuring and orderly change of control, and should not degenerate into a mechanism for value-destructive liquidations.

Time bound resolution should certainly not be confused with restoration of performing assets within the stipulated time of 270 days. It may not be possible to resolve stressed assets of thousands of crore in a short span.

What could be done in the 180 days is to get a concrete reorganisation plan. This should include the appointment of a competent interim management for a turnaround, setting a business plan and valuation after reorganisation, arrangement of interim financing, listing and asset reorganisation, debt write-downs, equity streamlining, payout agreements across all creditors and a qualified pipeline of new investors.

The resolution process done right should see gradual value accretion and price discovery mechanism kick-in for the reorganised asset. The credible threat of liquidation should be used to move the resolution process forward, and not as a primary premise for the bankruptcy.

After all processes fail, liquidation would be inevitable.

The priority is to resolve the present and future dangers of the bad loans, which if unresolved will likely lead to asset destruction, and consequently choke off liquidity of lending institutions.

Liquidations should always be the last option.

Emerging Code

IBC is young and can prove its effectiveness with the test of time

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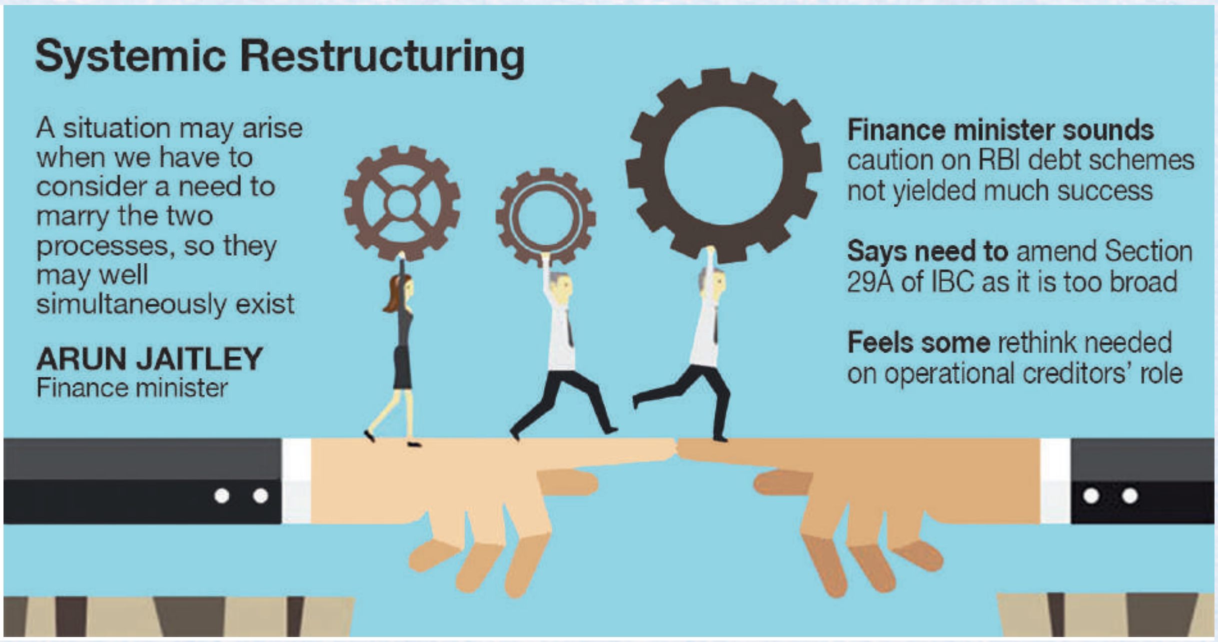
The Insolvency and Bankruptcy Code has been accredited as the most important reform from the present government.

The Code has made a valiant attempt to bring, for the first time, a balance between lenders and borrowers, and resolve stressed assets in a time bound manner.
Much has been discussed and debated in the recent times about the success and efficacy of the Code and its process.

Yes, it is a fact that the Code is young and will have to pass through time to prove its effectiveness. That it has stirred a hornet's nest by sending a signal to all lenders of defaulting corporate and individuals that stressed assets have to be resolved and recovery has to be effected. Already a few big names in the industry, that have been languishing for years, have been resolved.

Already there have been amendments to the Code and inclusions to plug loopholes and seal cracks that could delay the process of resolution. This will be an ongoing process and hopefully many more such initiatives from the government would be seen in days to come.

Recently, the finance minister Arun Jaitley remarked that the option of "marrying" the insolvency framework with a possible settlement scheme to deal with resolution of debt-laden companies is something that can be considered in the future. However, this can only be taken up as food for thought after the first batch of bankruptcy cases gets cleared. The government will therefore keep a watch if the revival is only through the Insolvency and Bankruptcy Code or otherwise.



It is a fact that the various government schemes for settling and restructuring debt had not yielded much success in the past. Schemes for corporate debt restructuring, sustainable structuring of stressed assets (S4A), strategic debt restructuring and flexible structuring of existing long term project loans were abolished. The Joint Lenders' Forum, designed to resolve potential bad debts, was disbanded. The government, through the implementation of the Insolvency and Bankruptcy Code plans to create an honest borrower and creditor platform which would be a great impetus for future business growth of the country.

Much effort might be required to enable a successful transformation of the borrowing landscape. With the rush of activity so far witnessed, it is important that all stake-holders, including judiciary, enhance capacity. It is feared, and not unjustifiably so, that the lack of infrastructure in the judicial system will ultimately be a road block to fast resolution process. The number of qualified resolution professionals will also require augmentation.

The process has already seen a number of flags being raised by many involved. However, not all can be addressed at present. It may be mentioned here that the Supreme Court had suggested that operational creditors of bankrupt firms be given a voice in resolution in proportion to their debts, and include their voting rights.
However, the crucial thought remains and will be addressed through the creation of codes such as the IBC. The government should begin the process of putting a credible institutional structure as an intermediary between itself and banks. Given the easy option of using tax money to offset banking problems, the biggest risk to the financial system remains state control of banks. Unless that is addressed in a meaningful way, banking crises are fated to recur and the taxpayer will be endlessly drained.

The health of a banking system depends on the incentives bankers have in being mindful of risks and in being transparent about the true state of affairs. Governance is an issue to be recognised as an important paradigm to ascertain and implement good practices in the banking system.

It is generally thought that the recapitalisation of public sector banks should not be delayed any further to tide over the current financial crisis. This being done already to a great extent, critical, game changing legislations such as the Insolvency and Bankruptcy Code can emerge and evolve to meet the requirement of the day as it has been designed for.

Amending The Code

Revisions made are aimed at removing shortcomings and challenges and ensure smooth functioning of IBC

The Insolvency and Bankruptcy Code has undergone changes through amendments to keep up with the emerging requirements and to remove ambiguities and loopholes. The intention has been to make the Code be in line with its objective and purpose. These amendments have removed shortcomings and challenges which would have otherwise hindered smooth functioning of the process.

Some of the major changes which the Code underwent in the past two years of its existence in form of amendments have been discussed in the ensuing section.

The Insolvency and Bankruptcy Code (Amendment) Bill, 2017 was introduced in Lok Sabha on December 28, 2017. It was passed by the Lok Sabha the following day and was passed by the Rajya Sabha on January 2, 2018.

The Bill amended the provision of a resolution applicant and defined it as a person who submits a resolution plan after receiving an invite by the insolvency professional to do so. Earlier the code defined a resolution applicant as a person who submits a resolution

plan to an insolvency professional.
The eligibility for the resolution applicants has also been amended. The amendment to this provision states that an insolvency professional will only invite those resolution applicants to submit a plan who fulfil certain criteria laid down by him after meeting the committee of creditors.

Other conditions that may have been specified by the Insolvency and Bankruptcy Board will also have to be fulfiled. Earlier, the Code had specified that an insolvency professional will take control of the defaulting company, and invite applicants to submit resolution plans. This now stands amended as stated above.

The amendment bill prohibits certain persons from submitting a resolution plan.

A person will be ineligible if :

- He is an undischarged insolvent (individual unable to repay his debt)
- Is a wilful defaulter
- His account has been identified as a NPA for more than a year and he has not repaid the amount before submitting a plan
- He has been convicted of an offence punishable with two or more years of imprisonment
- Has been disqualified as a director under the Companies Act, 2013
- Has been prohibited from trading in securities by SEBI
- He is the promoter or in the management of a company which has indulged in undervalued, preferential or fraudulent transactions
- Has not honoured a given guarantee on a liability of the defaulting company undergoing resolution or liquidation
- He has indulged in these specified activities abroad
- He is connected to any person mentioned above and includes promoters, management or any person related to them.
- The Bill exempts scheduled commercial banks, asset reconstruction companies and alternate investment funds if they are connected to any such person.

Amendment to the IBC 2016 states that the committee approving a resolution plan will approve such plan by a 66 per cent majority, subject to any conditions specified by the Insolvency and Bankruptcy Board. Earlier, it was stated that the committee of creditors could approve a resolution plan with 75 per cent majority.

The Bill prohibits the committee of creditors from approving a resolution plan submitted before the promulgation of the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2017, where the plan has been submitted by a person ineligible to be a resolution applicant. In case of liquidation, the amendment bill prohibits the insolvency professional to sell this property to any person who is ineligible to be a resolution applicant. The amendment bill also inserts a provision to specify that a person contravening any provisions of the Code, for which no penalty has been specified, will be punished with a fine ranging between from ₹1 lakh to ₹2 crore.

Home Buyers - New class of Financial creditors

In June 6, 2018, in yet another amendment, sweeping changes were made that highlighted procedural aspects relating to the insolvency process. A major change was made which helped many individuals who have had their money stuck in building projects. An ordinance had the presidential endorsement bringing relief to home buyers by recognising their status as financial creditors. This gave them due representation in the 'Committee of Creditors' and made them an integral part of the decision making process. It also enabled home buyers to invoke Section 7 of the Insolvency and Bankruptcy Code 2016 against errant developers. They would rank as other financial creditors and recover in line with them, in case of a liquidation. They could demand a refund of the entire amount as advance or paid interest per month of delay till possession is handed over, as per the Real Estate (Regulations and Development) Act 2016, section 18.

The 2018 Ordinance has clarified that the moratorium imposed by the NCLT under Section 14(1) (at the time of admission of an insolvency application) will not apply to guarantee contracts in relation to the corporate debtor's debt.
Section 61(3) was amended to ensure that the NCLT will also have jurisdiction over the insolvency resolution of the corporate guarantor. Previously, this provision covered personal guarantors only.

Withdrawing Insolvency Proceedings

Section 12A was introduced permitting the NCLT to now allow insolvency proceedings to be withdrawn provided it has the consent of 90 per cent of the voting share of the CoC members. Certain additional conditions for withdrawal have been prescribed under the regulations. The section also lowered the voting threshold to 51 per cent for routine discussion. These allowed quick decision making possible and improved the prospects for approval of viable resolution plan to be put in place.

Fourth Amendment

In the fourth amendment in October, 2018, a few critical changes were made.
When amended this was substituted to provide that the amount due to operational creditors under the resolution plan will be paid prior to financial creditors.

MSME

Another major beneficiary was Micro, Small and Medium Sector Enterprises (MSME), which form the backbone of the Indian economy as the biggest employer, next only to the agriculture sector. Recognising the importance of MSME sector in terms of employment generation and economic growth, the ordinance empowered the government to provide them with a special dispensation under the Code. The immediate benefit provided is that it does not disqualify the promoter to bid for his enterprise undergoing Corporate Insolvency Resolution Process (CIRP), provided he is not a willful defaulter and does not attract other disqualifications not related to default. It improves opportunities of resolution for MSMEs under CIRP apart from empowering the government to allow further exemptions or modifications with respect to the MSME sector, if required, in public interest.

Related Party

Section 29 (A) of IBC was amended to widen its applicability and provided limited exemptions to resolution applicants by tweaking the eligibility criteria.
The definition of 'related party' in context of an individual person was introduced, providing clarity to the scope of connected persons who have to be tested for disqualifications set out in paragraphs (a) through (i) of Section 29A. The definition of an individual's related party is extensive and casts a wide net.

The ordinance also identifies certain 'financial entities' who have been exempt from the NPA disqualification provided that such financial entities are not related to the corporate debtor.

Under this, Regulation 38 of IBBI (Insolvency Resolution Process for Corporate Persons) was amended with the following changes:

- Priority in payment to Operational Creditors(OC) under resolution plan over Financial Creditors (FC).
- Removal of requirement of making payment to OCs within 30 days from the date of approval of resolution plan by Adjudicating Authority.
- Removal of the reference to dissenting financial creditors. Since the reference to Dissenting Financial Creditors has been removed from Regulation 38, as a consequence the definition of "Dissenting Financial Creditor" has been omitted.

The regulations earlier had provisioned payment of liquidation value to operational creditors and dissenting financial creditors as a priority. The amendment has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substituted the regulations to provide that the amount due to operational creditors under the resolution plan shall be paid on priority over financial creditors. Thus, dissenting financial creditors have been taken off from the regulations.

The above amendment was brought in with an intent to streamline the regulations with the provisions of the Code, particularly Section 30, that stipulated the minimum payable amount to operational creditors is the liquidation value and the Board shall only specify the manner of payment. In the earlier regulation 38, it was stated that "liquidation value due to operational creditors" was read in a manner to imply that only liquidation value is payable to them. The amendment clears the ambiguity.

Voting by CoC

The process regarding meeting and voting of the Committee of Creditors was amended under Regulation 21(3). Earlier all members of the Committee of Creditors were required to be present at the meeting of the Committee of Creditors during the time of voting. The Regulations earlier required the resolution professional to circulate the minutes of the meeting by electronic means to all members of the committee of creditors within 48 hours after the meeting is concluded and seek a vote of the members who did not vote at the meeting.

Regulation 25 was amended to require the resolution professional to circulate minutes of the meeting by the committee of creditors to the "Authorised Representative" of a class of creditors. A new provision was inserted that required such authorised representatives to circulate the minutes to the creditors within the class and provide a 12-hour voting window with a clear 24 hour notice.

Post Admission Withdrawal

The ordinance now permitted the NCLT to allow insolvency proceedings to be withdrawn provided it has the consent of 90 per cent of voting share of the CoC. This follows the Supreme Court's decisions to permit withdrawal of insolvency proceedings post admission on a case specific basis.

Certain additional conditions to withdraw insolvency proceedings have been prescribed under the regulations as mentioned below:

The application to withdraw must be submitted:

(i) by the same person who had filed the insolvency application to the resolution professional in the specified format prior to issuance of the invitation for expressions of interest (pursuant to Regulation 36A); and

(ii) be accompanied by a bank guarantee for the specified amounts. The application submitted to the resolution professional must be approved by the CoC by the relevant majority within seven days (of the constitution of the CoC or the application, whichever is earlier) and the resolution professional is required to submit the application to the NCLT within three days of such approval.

Chapter 5

Decoding The Code

Reflecting On Two Years of Judicial Interpretation

Ran Chakrabarti

Lawyer

Introduction

New pieces of legislation are inevitably pregnant with interpretational issues and lawyers naturally take delight in arguing what the statutory drafters actually meant or intended. Why did the legislators use particular words in certain sections, and other words, in other sections? The Insolvency and Bankruptcy Code, 2016 (the "Code") is no exception to this rule and we have seen a number of decisions over the last two years clarifying the intent and purpose of the legislation. So where do we stand two years in from the enactment of the Code and what is the report card looking like? In this article, we will consider how the Code works and address some of the key interpretational conundrums that have arisen in recent jurisprudence and their potential implications.

How The Code Works

Generally the Code intends to recycle distressed capital in a time-bound manner and classifies different classes of creditors who can invoke the corporate insolvency resolution process. Financial Creditors (those who are owed money for providing debt) can invoke the process under Section 7 and Operational Creditors (essentially suppliers of goods and services) can invoke the process under Section 9.

The mechanics of the Code permit a creditor to trigger insolvency proceedings against a debtor through an application to the National Company Law Tribunal (the "Adjudicating Authority"). On receipt of a petition by a Financial Creditor under Section 7 of the Code, the Adjudicating Authority is given 14 days to either admit or reject it, depending on whether it is satisfied that a default has occurred, the petition is complete and there are no claims against the insolvency resolution professional. In the event that the petition is incomplete, the Adjudicating Authority is required to grant a further 7 days for the financial creditor to rectify the defect.

In the case of petitions made by Operational Creditors under Section 9 of the Code, following the expiry of the 10-day period from delivery of a notice of claim against the corporate debtor, it may petition the Adjudicating Authority to initiate the corporate insolvency resolution process. Following receipt of the required information in the application, the Adjudicating Authority has 14 days to either accept or reject the petition and if the claim is not complete, it shall grant the operational creditor a further 7 days to rectify its application.

The astute might ask at this point, why are there two different mechanisms for the admission of an insolvency claim and should there be any difference? On the face of it, Financial Creditors do not have to make a demand against the corporate debtor, in the same way that an Operational Creditor has to; and some have argued that this denies a corporate debtor's right to challenge a claim by a Financial Creditor. Nevertheless, others point out that the Adjudicating Authority, in admitting a claim by a Financial Creditor, has to be satisfied that the financial debt is outstanding; which implicitly means that it must take account of whether the corporate debtor is factually in default of repaying money that is owed, due and payable.

Assuming that the application of a Financial Creditor or an Operational Creditor is admitted, an insolvency resolution professional essentially takes over the day-to-day affairs of the corporate debtor and a committee of Financial Creditors (the "Committee of Creditors") is established to work out a resolution plan, considering applications by third parties ("Resolution Applicants") on how they might take over the business and restructure the debt.

Pursuant to Section 12 of the Code, the time limit to determine the insolvency resolution process is 180 days, extendable on one occasion by up to a further 90 days to a maximum of 270 days (the "Moratorium Period"). During the Moratorium Period, all claims against the corporate debtor are halted (including any existing claims) and are essentially subordinated to the resolution process. If the Committee of Creditors cannot agree and submit a resolution plan to resolve the insolvency within that time frame, or it rejected by the Adjudicating Authority, then pursuant to Section 33 of the Code, the Adjudicating Authority is required to liquidate the corporate debtor and what value remaining in the business is statutorily carved up to meet employees dues, debts to financial and operational creditors and, if anything remains after that (which is generally never the case), to shareholders.

There is no doubt that the Code has triggered a seismic shift in boardrooms across the country, swinging the balance of power away from recalcitrant debtors who could previously rely on creditors getting stuck in the red tape of cumbersome enforcement procedures, wrapping them up for years in the pursuit of their claims before a multitude of legal forums. But now, creditors have a powerful new weapon to effectively and efficiently recover money owed to them.

Interpretational Conundrums

The implementation of the Code, however, has raised a number of key questions over the last two years. Before the Code, corporate debtors could safely rely on kicking in to touch claims for debt, knowing that the system was going to delay the outcome: but with the Code essentially shifting the balance of power towards creditors, can they take unfair advantage in triggering insolvency proceedings against a corporate debtor over unpaid dues which are disputed?

The insolvency of major housing construction contractors has also raised interesting questions on the classification of homebuyers and what happens to their deposits, only recently resolved during the summer of 2018, with an ordinance clarifying that homebuyers fall into the category of Financial Creditors. In the context of Resolution Applicants, interesting questions have arisen over whether related parties of a corporate debtor can submit a rescue plan; arguably letting them profit from a failed business, which they themselves, might have deliberately run into the ground, by permitting them to potentially purchase assets at a discounted price?

Predictably, questions on whether the time frames in the Code are mandatory or do the courts have a degree of discretion in exercising flexibility to the process, have arisen. This question has arisen in two different contexts, firstly, where the Adjudicating Authority is required to make decisions within a particular time frame, often with incomplete information (and the request for such further information is delayed); and secondly, in the context of the actual resolution process itself: should the axe fall on the date falling 270 days after the admission of the petition, if the Committee of Creditors and any resolution applicant cannot agree any rescue plan?

Other areas of uncertainty have revolved around the question of the moratorium of claims during the Moratorium Period and whether they should apply to guarantors of the corporate debtor. On the one hand, some argue (including the author) that they should, since if the debt is restructured or a successful resolution applicant replaces the existing promoters, then necessarily, the existing debt will either be restructured or discharged and new guarantors of the successful resolution applicant should replace pre-existing guarantees in relation to the restructured debt.

Others, however, have argued that guarantees are distinct contracts, and should continue in force. I would however, emphasise that should a guarantee be enforced during the Moratorium Period, it will necessarily discharge part of the liabilities of the corporate debtor and a particular creditor may receive undue advantage in having its debt discharged over and above other creditors of the corporate debtor.

Let's now take a look at a several landmark decisions, interpreting key provisions of the Code, addressing some of these, and other, question marks.

A Disputed Debt

A common response by corporate debtors to unpaid operational creditors who file a claim for insolvency under Section 9 of the Code is that the money owed is disputed.[2] A standard stock reply from the debtor's legal counsel to such a notice threatening the instigation of insolvency proceedings if the money owed is not paid, is that the underlying contract relating to the debt has not been satisfactorily performed. The intent is clear: the debtor hopes to rely on wrapping up its creditor with long and protracted legal proceedings over whether the money is actually owed or not.

So how does the Code deal with this problem? Well, Section 8 basically says that an operational creditor may, on the occurrence of a default, issue a notice to the debtor demanding payment and the debtor has 10 days to respond, demonstrating that either: there is an existing dispute or a record of the pendency of a suit or arbitration proceedings filed before the receipt of the notice; or otherwise, evidence confirming that the money has been paid.

If the debtor cannot demonstrate evidence of a dispute, or otherwise demonstrate that the money has been paid, then following the expiry of that 10-day period, the operational creditor may file an application to initiate the insolvency resolution process under Section 9 of the Code.

Interestingly, under the Code, the definition of a "dispute" includes a suit or arbitration proceedings relating to: the existence or the amount of debt; the quality of goods or service; or the breach of a representation or warranty. The astute lawyer will immediately focus on the word includes and will ask the question whether it should be construed with, or without limitation. Put otherwise, can it also include other potential scenarios that are not expressly referred to in the definition?

The meaning of the word dispute formed a key part of the judgment in DF Deutsche Forfait AG and Anr. V. Uttam Galva Steel Limited (the "Uttam Galva Case") where the Mumbai NCLT sensibly concluded that a dispute couldn't be just a mere denial of the creditor's claims. It has to be much more substantial than that. Put otherwise, a corporate debtor can't just respond by saying that the money isn't owed and therefore, the insolvency proceedings should be thrown out. This would otherwise have the effect of denying all creditors the ability to effectively and efficiently process their claims. What the corporate debtor has to demonstrate is that it acted to file a legal case disputing that the money was owed before receipt of the notice under Section 8 of the Code.

While judicial interpretation has been fairly firm on this, perhaps we should take note that the reference to includes replaced the word means in an earlier draft of the Code, suggesting that there is perhaps greater flexibility in the definition of a dispute than we might otherwise accord?

The question on the meaning of a dispute arose again, but this time, before the Supreme Court in the case of Mobilox Innovations Private Limited v. Kirusa Software Private Limited (the "Mobilox Case").

Essentially, the Mobilox Case involved a claim by an operational creditor against a corporate debtor in relation to the failure to pay amounts due to the creditor for the provision of services subcontracted by the debtor. Essentially, the debtor argued that the creditor was in breach of a separate obligation of confidentiality under a non-disclosure agreement (the "NDA") relating to the provision of the services and correspondence relating to that breach was traded between the parties before the creditor pressed the insolvency button.

The question before the Supreme Court was whether that communication of alleged breach of the NDA constituted a dispute within the meaning of the Code, essentially invalidating the creditor's notice to invoke the insolvency resolution process? Put otherwise, was the existence of a dispute between the parties limited to the contractual terms for the provision of the service, or could it relate to a separate but related dispute between the parties in parallel, and would that invalidate the creditor's invocation of the insolvency resolution process?

Clearly, the correspondence between the parties suggested that there was a dispute over the payment, linked to the alleged breach by the creditor of its obligations under a related agreement. The Mobilox Case, therefore, is authority to suggest that a dispute need not be one that has been formally referred to the courts or arbitration and that the correspondence between the parties before the invocation by the insolvency resolution notice can serve as prima facie evidence of such a dispute.

This is an interesting judgment. Clearly, the Supreme Court's judgment in the Mobilox Case certainly waters down the strict interpretation reached by the Mumbai NCLT in the Uttam Galva Case. But was the debtor warranted to withhold payment (essentially by way of set-off), in response to the alleged breach by the creditor of the NDA? One might suggest that the payment for services on the one hand and the obligation of confidentiality on the other hand are two separate and distinct legal obligations and that the debtor's right is to prove the breach of confidentiality and claim damages against the creditor in parallel proceedings?

What we can perhaps conclude from these two cases though, is that there is clearly a threshold for the existence of the dispute between a debtor and a creditor. On the one hand, a debtor cannot simply avoid proceedings through a frivolous or a sham defense intended to delay due process; but yet on the other hand, the debtor does not necessarily have to demonstrate the filing of a legal claim disputing the amount owed, before a creditor files under Section 9 of the Code.

Resolution Applicants And Connected Persons

Back in April 2018, Electrosteel Steels Limited became the first of twelve big-ticket distressed debt situations identified by the RBI, to successfully work out a debt restructuring under the insolvency resolution process. In that case, the Kolkata bench of the NCLT cleared Vedanta's ₹5,370 crore rescue package, essentially taking over the distressed steel-maker, discharging less than 50 per cent of its outstanding debt.

The case raised a number of issues and in particular, the issue of who could be a resolution applicant under Section 29(A) of the Code, sparking controversy over the eligibility of the successful bidder. Essentially, question marks were raised over whether the successful resolution applicant should have been disqualified, on the basis that an affiliated company of the successful bidder had violated local environmental laws in relation to a mining project in Zambia.

At the time of submission, Section 29(A)(d) of the Code essentially stated that a person who has been convicted of an offence, punishable with imprisonment for two or

more years cannot be a resolution applicant; and at the time of the submission, this applied also to connected persons, which, the accompanying notes to the section clarified, included reference to associated companies as well as individuals, who were promoters or directors of the resolution applicant (or the associated company).
It is interesting to note that this section was amended in June 2018, limiting it to a violation of specified Indian legislation or any other law in force, where the punishment for the offence exceeded 7 years; and further qualifying that it did not apply to connected persons of the resolution applicant.

Even on the basis of the wording of Section 29(A)(d) the time of the original submission, which included a connected person of the resolution applicant, having been convicted of an offence punishable by two or more years imprisonment, it is difficult to see how the challenge could have any substance in the absence of a director of the associated company of the resolution applicant having been so convicted?
Interestingly, the jurisprudence on what we mean by punishable is an interesting one. Some would suggest that if imprisonment is a possibility, then whether or not anyone went to jail or not is irrelevant. Furthermore, there are interesting questions on whether a company (a separate juristic person) is capable of criminal punishment. While the directors of a company are (if found culpable of particular acts) punishable by a prison term, it is illogical to suggest that a company can actually be punished with a prison term.

The related Zambian legislation, which the associated company was found in breach of provided for a liability of a fine or a prison sentence not exceeding three years, or both. The question therefore was whether this could equate to the meaning of Section 29(A)(d) of the Code.

The Zambian court judgment simply fined the group company and nobody was punished criminally. On appeal, the NCLAT confirmed the decision of the NCLT in August 2018, ruling out the applicability of Section 29(A)(d) of the Code, dismissing the challenge.

The legal conundrums raised by this case are interesting ones and it is perhaps one of the reasons why the Code was amended during the early summer of 2018 to remove the applicability of this provision to connected persons, though the paradox of whether a company can be punished in the same way that an individual can for its actions still remains.

Conflict Of Legislation And The Meaning Of Default

The matter of Innoventive Industries Limited v ICICI Bank involved a number of issues and twists (which, by the way, was the first application made under the Code), finally settled before the Supreme Court in September 2017. In this matter, ICICI Bank filed a claim against Innoventive Industries under Section 7 of the Code, in its capacity as a Financial Creditor of unpaid debt.

Innoventive argued that its liabilities stood suspended under by an order passed by the Maharashtra State Government pursuant to the Maharashtra Relief Undertaking (Special Provisions) Act, 1958 (the "MRUA"). The National Company Law Appellate Tribunal (the "NCLAT"), rightly dismissed Innoventive's appeal, stressing that the Code was overarching and that its provisions took precedence over other legislation. The Supreme Court further held that the MRUA was repugnant to the Code, since its provisions would otherwise defeat the purpose of insolvency resolution and it also held that the non obstante clause in the Code (the clause giving it precedence over all other laws) took precedence over the non obstante clause in the MRUA.

On a separate question, the Supreme Court set out a detailed interpretation of the Code, stressing that any financial creditor of the corporate debtor can file an application under Section 7, even if the default was triggered under the financing documents of its other financial creditors. Put otherwise, the default need not be in relation to the applicant financial creditor.

This makes total sense. Should the corporate debtor default on repaying other indebtedness, in well drafted loan documentation, this will trigger a cross default across the corporate debtor's other loan documentation, essentially making those debts immediately repayable; and such debts become due.

Time Bound Claims?

In the matter of J K Jute Mills Company Limited v. Surendra Trading Company, the question before the Supreme Court was whether the 14-day time limit prescribed under Section 9 of the Code for admitting or rejecting a petition or initiation of the insolvency resolution process was mandatory and further, whether the time bound provision to rectify defects in any application within 7 days of receipt of notice was obligatory.

The NCLAT had earlier ruled that the time lines for admitting a claim under the Code were directory and not mandatory because they were procedural in nature. However, curiously, the NCLAT further held that the time lines for perfecting an incomplete application was mandatory, without giving much reasoning on the matter.[3]

The Supreme Court, considering the matter, set aside the ruling of the NCLAT, pointing out that rejecting the application on the grounds that it had not been perfected within the specified time period did not preclude the creditor from filing a fresh claim at a later date; and therefore, it served no practical purpose to reject the application purely on the basis of the applicant failing to provide such further information as may be necessary within the time line.

The Supreme Court further stressed that it was in any event, in the interests of the applicant to correct any error in the original submission as soon as possible, in order to accelerate its claim. It did, however, note that in a vexatious or frivolous application, extending the time for perfecting the petition, might unduly serve the interests of the creditor and therefore, the Supreme Court laid down a sensible requirement that any such delayed perfection to the application must be accompanied with good cause, without which, the Adjudicating Authority should dismiss the claim.

But there is another aspect to time-bound-claims, which we need to consider before closing the discussion on this issue. While the above decision by the Supreme Court considers the procedural provisions in the Code, what about debts, which have been outstanding for substantial periods of time where creditors have failed to take action?

In June 2018, the Code was amended with the insertion of Section 238A, expressly stating that the provisions of the Limitation Act shall apply to proceedings before the Adjudicating Authority. Consequently, in the matter of B.K. Educational Services Private Limited v. Parag Gupta & Associates, decided by the Supreme Court in October 2018, it was held that the Limitations Act, 1963 (the "Limitation Act") will apply to applications filed under Section 7 and Section 9 of the Code.

Essentially, this means that a claim filed for insolvency resolution after the Code came into effect cannot resurrect a claim for debt that would otherwise be time-barred under the Limitation Act; and further, a claim submitted after the Code came into force and before Section 238A was introduced is further precluded, because otherwise, a claim for debt that would otherwise be time-barred, would essentially become resurrected. Essentially, the right to sue under the Limitation Act exists for a period of three years from the date when the default occurred.[4] Should a creditor fail to do so, it cannot rely on the Code to resurrect such a claim.

Moratarium On Claims

Sensibly, Section 14 of the Code freezes claims against the corporate debtor (including pre-existing claims) during the Moratorium Period, with the rational of bringing all creditors together and regulating their claims against the assets of the corporate debtor, in accordance with the Code. This makes complete sense, since the assets of the corporate debtor need to be preserved in the interests of all creditors, whether a resolution plan is agreed, or otherwise, the corporate debtor is liquidated and the assets are distributed between creditors in accordance with the hierarchy under the Code.

Nevertheless, the question arises whether the moratorium on claims applies to claims by creditors against guarantors of the corporate debtor and in the recent matter of State Bank of India v. V Ramakrishnan & Anr, the Supreme Court held that the moratorium does not apply to claims against guarantors.

This is a controversial decision. On the one hand, it upholds the sanctity of the guarantee and the right of a creditor to pursue a claim against the guarantor to discharge the debt owed by the debtor; and it is well settled law that the obligations of the guarantor and the principal debtor are co-extensive (meaning essentially that a creditor may choose to go after either of them).

However, complexities arise by allowing a creditor to continue to pursue a claim against a guarantor during the Moratorium Period. Firstly, in the event that the guarantee is discharged, the creditor's debts are discharged and it should no longer be deemed to be a creditor in the insolvency proceedings; and furthermore, the calculation of outstanding debt owed by the corporate debtor will need to be re-calibrated. Secondly, could it result in a scenario where an Operational Creditor with the benefit of a guarantee, recovers its dues ahead of secured financial creditors and if so, should this matter?

Thirdly, and perhaps more troublesome in the view of the author, is that the claim under the guarantee complicates any resolution plan which may involve the restructuring of debt, or the acquisition of the corporate debtor by a resolution applicant. If a creditor is owed ₹100 by the corporate debtor and during negotiations during the insolvency resolution process, agrees to a haircut of the debt to say, ₹70, it would be inequitable for the creditor to claim ₹100 from the corporate debtor's guarantor?
Furthermore, if a resolution applicant renegotiates the debt and acquires the corporate debtor, the existing guarantors should be released from their obligations and the new shareholder should provide a replacement guarantee to the creditor. Otherwise, it would be inequitable for a guarantor to discharge debt over an entity that it no longer has any holding in? In addition, a conundrum arises in the context of the guarantor and its ability to recover from the restructured corporate debtor? What rights does the guarantor have against the corporate debtor and where does his claim rank amongst other creditors? Presumably, the guarantor should become a Financial Creditor?

Constitutionality?

Just over a week or so ago, the Supreme Court[5] at the end of January, predictably (and correctly) upheld the constitutionality of the Code, following a number of petitions alleging that it was discriminatory between Financial Creditors and Operational Creditors. In a nutshell, it's Financial Creditors that constitute the Committee of Creditors under Section 21 of the Code, which essentially controls the resolution outcome, over and above Operational Creditors (who have no say in the sanctioning of any resolution plan).

While in most cases this makes sense, it is theoretically possible that a corporate debtor may have no debt, yet still owe money to operational creditors. Furthermore, it is not impossible to imagine a scenario where money owed to Operational Creditors could potentially be greater than debt owed to Financial Creditors; and in such circumstances, an Operational Creditor could be unfairly prejudiced?

Nevertheless, Financial Creditors will be acutely aware that in any restructuring plan, the business still needs its providers of goods and services and therefore, it would be fool-hardy for a Financial Creditor to agree a resolution plan which didn't secure the continued supply of those goods and services from its existing Operational Creditors (and necessarily, a fair discharge of their dues), in order to keep the business running.

In its judgment, Supreme Court also laid rest to a long standing dispute over the provisions of Section 29A of the Code, introduced just over a year ago, essentially ruling out certain categories of persons from being resolution applicants. The judgment makes it clear that related persons should be construed narrowly and limited to those directly connected to the corporate debtor. This is a sensible conclusion, as the class of persons permitted to be resolution applicants should not be unduly narrowed, keeping in mind the broader public policy aim to facilitate a resolution of the insolvency.

Forcing Creditors To Be Free

An interesting question has arisen in the context of a Reserve Bank of India (the "RBI") circular dated 12 February 2018 (the "Circular"), essentially directing lenders with distressed debt exposure in the power sector, to call in their loans, forcing them to instigate the corporate insolvency resolution process.

The Circular required banks to identify loans as special mention accounts following an event of default, according to the length of time that the borrower remains in default following a missed payment date, and the quantum of the outstanding payment. It further directed lenders to invoke their rights under the Insolvency and Bankruptcy Code, 180 days following the event of default.

This raises quite a significant implication, and to turn a phrase by the famous French political theorist, Jean Jacques Rousseau, in its directive, did the RBI essentially force creditors to become free? For good commercial reason, there is no mandatory obligation for a creditor to trigger insolvency proceedings against a debtor under the Code, because game theory and market conditions essentially drive the valuation of assets and therefore, the timing on monetizing stressed assets.

Yet the RBI, by directing lenders to bring down the curtain on non-performing loans in its drive to clean up the banking system has essentially done that and the saga should shortly end before the Supreme Court; where it will have to decide between public policy and harsh commercial realities.

Arguably, the RBI finally took the bull by the horns by issuing the Circular, forcing lenders to take action under the Code to recover their loans after an event of default continues beyond a particular period of time.

But the conundrum should be clear, and recognises a very harsh commercial reality. It goes back to the old age adage by John Paul Getty: "If you owe the bank a hundred dollars, that's your problem. If you owe the bank a hundred million dollars, that's the bank's problem." If there is no market for the assets, then what good is it to force lenders to liquidate them when they are likely to get a next to nothing return? It is because of this very problem, that creditors in general are at liberty to choose the time of exercising their rights, to maximise the chance of a recovery of their debt.

From the RBI's perspective, the move was aimed at tightening up the reporting regime within the banking system, flagging potential stress, triggering anticipatory remedial action before things spiralled out of control, or otherwise, requiring mandatory action where things have spiralled out of control. Logically, this should have lead to stricter discipline for scheduled debt repayments by borrowers and more prudent, future lending, since it would be harder to sweep bad lending decisions under the carpet.

The problem in practice however, is the relatively lapse discipline in payment cycles, making it difficult for borrowers to discharge scheduled debt repayments, if their revenue streams are substantially delayed. This is particularly astute in the power sector, with many state DISCOMs are financially stressed, leaving developers with revenue delay, triggering a breach of scheduled debt repayments. This is compounded on the other hand by potential liabilities to the DISCOMs for output failure, either due to delay in green-field construction for long awaited clearances and permits, or otherwise, a break down in fuel linkages during operation. Developer cash flows are clearly caught in a vicious circle.

Conclusions

Notwithstanding the teething problems in the interpretation of the Code and hard public policy decisions, we shouldn't loose sight of the wood for the trees and the enormous step forward the Code should provide in recalibrating lender confidence and credit flows into the economy. We are seeing a welcome paradigm shift from a system previously predicated on a right to unlimited debt without consequence to a much more prudent and responsible regime, recycling failed capital in a relatively time bound frame.

But there remain a number of elephants in the room: in particular, why haven't the public sector lenders in particular, invoked the Code to trigger the restructuring, sale or, otherwise, liquidation of moribund public sector borrowers? Air India would be a good case in point; for an insolvency resolution would no doubt achieve what the government has failed to do; a wholesale debt restructuring and asset rationalisation through a potential privatisation by the back-door, if a resolution applicant bail out the airline.

Ultimately, the true test of mettle for the Code will pivot on the sanctity of the 270-day resolution period. The axe must fall at some point in order to safeguard the interests of all creditors and we should not loose sight that liquidation of a distressed debtor is a liberating outcome for its creditors, who otherwise, would languish in perpetuity waiting for a remedy that will never materialise.

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[2] See for example the facts giving rise to an operational creditor filing insolvency proceedings under Section 9 of the Code against a corporate debtor for unpaid dues in the case of DF Deutsche Forfait AG and Anr. V. Uttam Galva Steel Limited before the Mumbai NCLT (C.P. No. 45/I&BP/NCLT/MAH/2017) [3]See paragraph 44 of the NCLAT ruling [4]See Section 137 of the Limitation Act [5]Judgement of the Supreme Court on 25 January 2019 in Swiss Ribbons Pvt Ltd & Anr v Union of India & Ors https://www.sci.gov.in/supremecourt/2018/4653/4653_2018_Judgement_25-Jan-2019.pdf

CORPORATE

CIRPs Yielding Resolution, April-June, 2018

Sl. No.	Name of CD	Not Going Concern/Erstwhile BIFR (Yes/No)	CIRP initiated by	Total Admitted Claims of FCs
1	Kalptaru Alloys Pvt. Ltd.	Yes	FC	51.19
2	Electrosteel Steels Ltd.	No	FC	13175.14
3	MBL Infrastructure Ltd.	No	FC	1428.21
4	Ved Cellulose Ltd.	No	FC	24.51
5	Bhushan Steel Ltd.	No	FC	56022.06
6	Wig Associates Pvt. Ltd.	No	CD	10.67
7	Nutri First Agro International Pvt. Ltd.	No	OC	1.82
8	MOR Farms Pvt. Ltd.	No	FC	32.52
9	Master Shipyard Pvt. Ltd.	No	OC	0.00
10	Orissa Manganese & Minerals Ltd.	No	FC	5388.54
11	Datre Corporation Ltd.	Yes	FC	84.86
12	Ellora Paper Mills Ltd.	No	FC	7.60
	Total			**76239.12**

CIRPs Yielding Resolution, July - September, 2018

Sl. No.	Name of CD	Not Going Concern/Erstwhile BIFR (Yes/No)	CIRP initiated by	Total Admitted Claims of FCs
1	Marmagoa Steel Ltd.	Yes	CD	120.58
2	A Power Himalayas Ltd.	No	FC	55.60
3	Keti Highway Developers Private Ltd.	No	FC	76.57
4	Zion Steel Ltd.	No	FC	5367.02
5	Adhunik Metaliks Ltd.	No	FC	5371.23
6	The Sirpur Paper Mills Ltd.	Yes	OC	533.38
7	Stesalit Ltd.	No	OC	49.73
8	Monnet Ispat & Energy Ltd.	No	FC	11014.91
9	Concord Hospitality Pvt. Ltd	No	FC	7.86
10	Amtek Auto Ltd.	No	FC	12605.00
11	Amit Spinning Industries Ltd.	Yes	FC	85.95
12	Jalan Intercontinental Hotels Pvt. Ltd.	No	FC	167.10
13	Arcee Ispat Udyog Ltd.	Yes	FC	64.03
14	Malabar Hotels Pvt. Ltd.	No	OC	33.76
15	Orchid Pharma Ltd.	No	OC	3341.55
16	Assam Company India Ltd.	No	FC	1379.17
17	Dooteriah & Kalej Valley Tea Estate Pvt. Ltd.	Yes	OC	15.89
18	Rajpur Hydro Power Pvt. Ltd.	No	FC	75.23
	Total			**40404.56**

PROCESSES

(Amount in ₹ crore)

Liquidation Value	Realisation by FCs	Realisation by FCs as % of their claims Admitted	Realisation by FCs as % of Liquidation value
27.48	31.60	61.73	114.99
2899.98	5320.00	40.38	183.45
269.90	1597.13	111.83	591.75
13.26	14.47	59.04	109.15
14541.00	35571.00	63.49	244.63
0.87	3.55	33.27	408.05
10.21	13.82	100.00	135.36
3.91	9.25	28.44	236.57
3.78	0.00	100.00	0.10
301.02	310.00	5.75	102.9
9.07	9.22	10.86	101.65
3.88	5.40	71.05	139.18
18084.36	**42885.44**	**56.25**	**237.14**

(Amount in ₹ crore)

Liquidation Value	Realisation by FCs	Realisation by FCs as % of their claims Admitted	Realisation by FCs as % of Liquidation value
34.54	31.05	25.75	89.90
6.31	23.13	41.60	366.56
10.28	18.50	24.16	179.96
14.55	15.00	0.28	103.09
431.50	410.00	7.63	95.02
202.76	340.00	63.74	167.69
15.06	19.28	38.77	128.02
2365.00	2892.12	26.26	122.29
107.72	47.86	100.00	44.43
4129.00	4334.00	34.38	104.96
25.96	22.04	25.64	84.90
103.00	108.82	65.12	105.65
6.99	15.10	23.58	216.02
89.93	138.86	411.32	154.41
1309.49	1292.22	38.67	98.68
359.91	884	64.10	245.62
4.228	15.89	100.00	375.83
31.95	9.45	12.56	29.58
9248.18	**10617.32**	**26.28**	**114.80**

SOURCE: *IBBI*

CIRPs Yielding Resolution, Till December, 2018

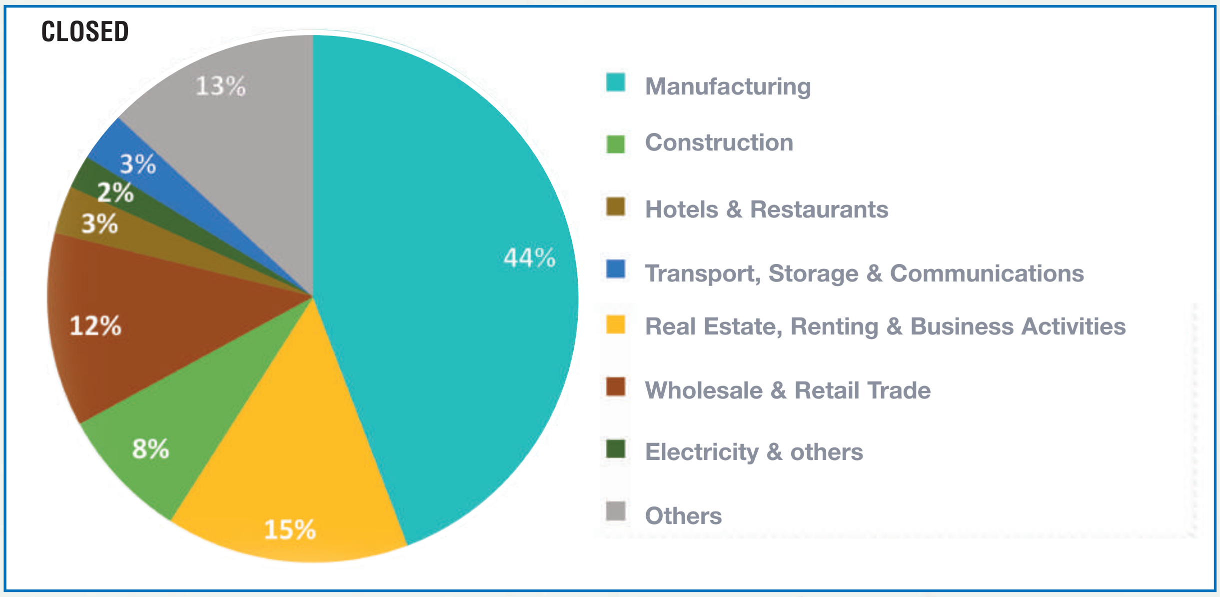
Sl. No.	Name of CD	Defunct (Yes/No)	CIRP initiated by	Total Admitted Claims of FCs
	Part A: Prior Period			
1	Basai Steels and Power Pvt. Ltd.	Yes	OC	853.69
2	Raj Oil Mills Ltd.	Yes	CD	243.19
3	BJN Hotels Ltd	No	FC	134.18
4	YashraajEthanoll Processing Pvt. Ltd.	No	FC	82.57
5	Admiron Life Sciences Pvt. Ltd.	No	CD	72.46
6	Paragon Steels Pvt. Ltd.	No	FC	181.75
7	S M M Steel Re-Rolling Mills Pvt. Ltd.	No	FC	41.46
8	Mohan Aromatics Pvt. Ltd.	No	FC	10.65
9	Frontline Printers Pvt. Ltd.	No	FC	62.90
10	S.M. Dyechem Ltd.	NA	CD	-
11	Southern Cooling Tower Pvt. Ltd.	No	OC	15.82
12	Shakti Nutraceuticals Pvt. Ltd.	Yes	FC	1.11
13	Quantum Ltd.	Yes	FC	32.18
14	NSR Steels Pvt. Ltd.	NA	FC	-
15	Vangal Amman Health Services Ltd.	NA	FC	-
16	Recorders and Medicare Systems Pvt. Ltd.	No	CD	103.16
17	Bhadravati Balaji Oil Palms Ltd.	Yes	30.05	18.47
	Total			**1865**
	Part B: October -			
1	Quality Rice Exports Pvt. Ltd.	Yes	OC	23.88
2	Cosmic Ferro Alloys Ltd.	No	FC	194.66
3	Universal Power Transformers Pvt. Ltd.	Yes	OC	37.82
4	Sun Paper Mill Ltd.	No	OC	20.99
5	ConnectM Technology Solutions Pvt. Ltd.	No	OC	0.90
6	Fenace Auto Ltd.	No	OC	483.41
7	Rave Scans Pvt. Ltd.	Yes	CD	122.22
8	Parte Casters Pvt. Ltd.	No	CD	6.30
9	Manor Floatel Ltd.	No	FC	34.46
10	Rishi Ganga Power Corporation Ltd.	Yes	FC	159.64
11	Binani Cements Ltd.	Yes	FC	6469.36
12	AGP Steels Pvt. Ltd.	No	CD	3.07
13	Vardhman Industries Ltd.	No	CD	133.84
	Total			**7691**

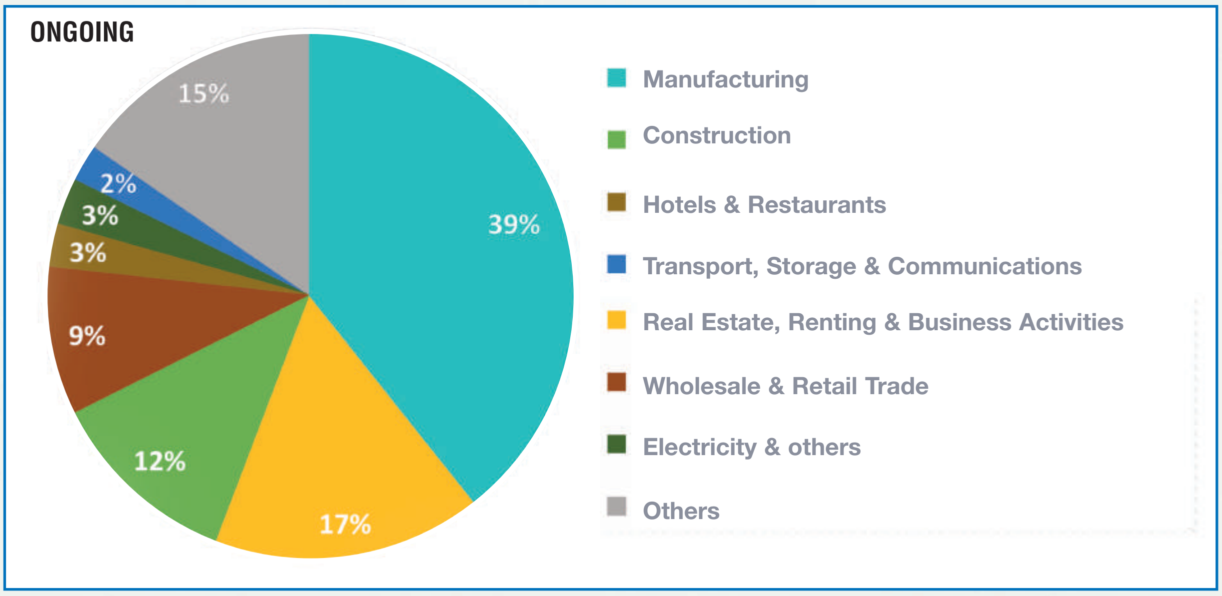
(Amount in ₹ crore)

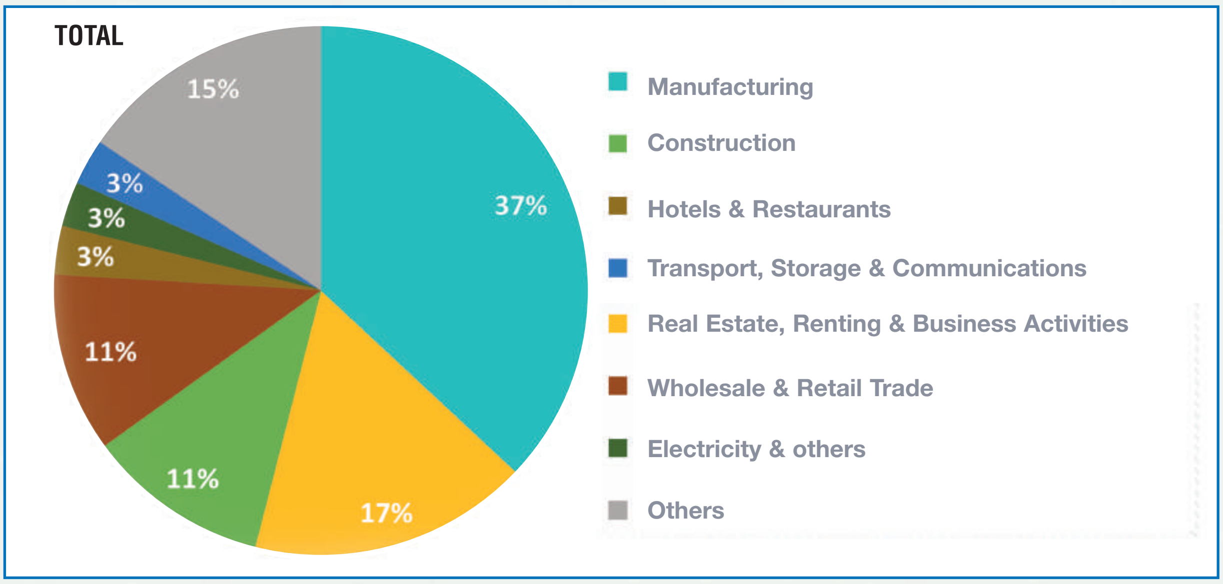
	Liquidation Value	Realisation by FCs	Realisation by FCs as % of their claims Admitted	Realisation by FCs as % of Liquidation value
(Till 30th September, 2018)				
	52.09	125.81	14.74	241.52
	22.83	55.87	22.97	244.72
	24.15	29.92	22.30	123.89
	12.40	14.67	17.77	118.31
	42.50	50.70	69.97	119.29
	37.71	41.50	22.83	110.05
	1.80	1.60	3.86	88.89
	3.75	4.72	44.32	125.87
	19.55	19.55	31.08	100.00
	-	-	-	-
	23.83	15.82	100.00	66.39
	0.00	1.18	106.31	-
	19.2	32.18	100.00	167.60
	-	-	-	-
	-	-	-	-
	14.83	45.29	43.90	305.39
	22.88	76.14	123.88	
	293	**462**	**25**	**158**
December 2018				
	7.40	10.86	45.48	146.76
	69.18	91.94	47.23	132.90
	12.47	13.50	35.70	108.26
	163.19	20.99	100.00	12.86
	0.01	0.90	100.00	9000.00
	104.80	127.44	26.36	121.60
	36.00	52.64	43.07	146.22
	1.30	1.79	28.41	137.69
	3.86	6.00	17.41	155.44
	15.38	45.12	28.26	293.
	2300.70	6469.40	100.00	281.19
	2.25	2.65	86.32	117.78
	62.07	62.50	46.70	100.69
	2779	**6906**	**90**	**249**

***SOURCE**: IBBI*

Sector wise distribution of CIRPs as on 31st December, 2018







SOURCE: *IBBI*

Corporate Insolvency Resolution Process

Quarter	CIRPs at the beginning of the Quarter	Admitted	Closure by				CIRPs at the end of the Quarter
			Appeal Review/ Settled	Withdrawal under section 12A	Approval of Resolution Plan*	Commencement of Liquidation	
Jan-Mar, 2017	0	37	1	-	-	-	36
Apr-Jun, 2017	36	129	8	-	-	-	157
July-Sept, 2017	157	232	18	-	2	8	361
Oct-Dec, 2017	361	147	38	-	7	24	439
Jan-Mar,2018	439	195	20	-	1 1	59	544
Apr - lun, 2018	544	245	20	1	14	50	704
Jul-Sept, 2018	704	235	30	26	32	83	768
Oct - Dec, 2018	768	264	7	36	13	78	898
Total	**NA**	**1484**	**142**	**63**	**79**	**302**	**898**

Initiation of Corporate Insolvency Resolution Process

Quarter	No. of CIRPs Initiated by			
	Operational Creditor	Financial Creditor	Corporate	Total Debtor
Jan-Mar, 2017	7	8	22	37
Apr-Jun, 2017	58	37	34	129
Jul-Sept, 2017	101	92	39	232
Oct-Dec, 2017	69	64	14	147
Jan-Mar, 2018	89	84	22	195
Apr-Jun, 2018	128	99	18	245
Jul-Sept, 2018	136	83	16	235
Oct-Dec, 2018	154	95	15	264
Total	**742**	**562**	**180**	**1484**

***SOURCE**: IBBI*


recovery
liquidation
NCLT
haircut
recovery
debtors
resolution
debtors
liquidation
haircut
debtors
NCLAT
debtors
recovery
haircut
debtors
NCLT
resolution
creditors
debtors
NCLAT
liquidation
NCLAT
haircut
liquidation
haircut
creditors
resolution
recovery


resolution
creditors NCLAT haircut
haircut liquidation
recovery
creditors
NCLT
haircut
debtors NCLAT
ditors
liquidation
rcut recovery haircut
rs debtors
solution NCLAT
covery
liquidation
haircut creditors recovery
debtors
recovery
on haircut recoveryhaircut
resolution
haircut
creditors
debtors
creditors haircut haircut
debtors NCLT
NCLT
NCLT
liquidation
infrastructure
haircut
steel
power
wer